A MANUAL OF
INDIAN COMPANIES LAW AND PRACTICE

VOL. I

(*Second Edition*)

A MANUAL OF INDIAN
COMPANIES LAW AND PRACTICE
INCLUDING
FORMS AND PRECEDENTS
VOL. I

(Second Edition)

BY

SOHRAB R. DAVAR,

BARRISTER-AT-LAW, AND ADVOCATE (O.S.)

Member of the Committee for Indian Companies Amendment Act, 1936 of the Government of India, First Indian Finalist of the Society of Incorporated Accountants (London) and Chartered Institute of Secretaries of Joint Stock Companies (London) Author of Law and Practice of Indian Private Companies, Law and Practice of Banking, Mercantile Law, Business Organisation, etc. Founder and Principal of Davar's College of Commerce, President of the Bombay Shareholders' Association.

With a Foreword by

THE HON. MR. JUSTICE H. J. KANIA, B.A., LL.B.

High Court of Judicature, Bombay.

CALCUTTA :

BUTTERWORTH & CO. (India) LTD.

AVENUE HOUSE

Bombay Branch : JEHANGIR WADIA BUILDING.

Madras Branch : 317, LINGA CHETTY STREET.

LONDON :	BUTTERWORTH & Co. (Publishers) Ltd.
AUSTRALIA :	BUTTERWORTH & Co. (Australia), Ltd.
NEW ZEALAND :	BUTTERWORTH & Co. (Australia), Ltd.
CANADA :	BUTTERWORTH & Co. (Canada), Ltd.
SOUTH AFRICA :	BUTTERWORTH & Co. (Africa), Ltd.

1937

PRINTED BY MANIK CHANDRA DAS
PRABASI PRESS, CALCUTTA

OTHER BOOKS BY THE SAME AUTHOR.

(1) LAW AND PRACTICE OF BANKING, 2nd EDITION.

For Bank Officers, practising Lawyers and Students. Recognised and recommended by Indian Institute of Bankers. An exhaustive text for reference and study with Cases, Forms and Precedents. Nearly 700 pages. (*Publishers :—Messrs. Butterworth & Co. (India), Ltd.*) Price Rs. 10.

(2) INDIAN LAW OF MEETINGS INCLUDING CLUB LAW.

An exhaustive treatise on the subject embracing all Statute and Case Law, both Indian and English. *An excellent book of reference for Legal* Practitioners, Managers, Secretaries, Shareholders, Public men and Club men. *(Oxford University Press, Bombay.)* Price Rs. 6.

(3) INDIAN MERCANTILE LAW, 7th EDITION.

Recommended as a Text-Book for University Degree Examinations and in use by B. Com. Students in Bombay, Allahabad, Calcutta, Lucknow, etc. Contains an exhaustive review of all branches of the subject in a simple, easy style with full text of the Contract Act, Sale of Goods Act, Partnership Act, and Negotiable Instruments Act. *(Publishers :—Messrs. N. M. Tripathi, Bombay.)* Price Rs. 7-8-0.

(4) ELEMENTS OF INDIAN COMPANY LAW, 2nd EDITION.

This book deals with Company Law in simple and easy style in form of chapters. An excellent book of Company Auditors, Secretaries, Agents and Directors. Recognised as a Text-Book for the Government Diploma in Auditing Examination. *(Publishers :—Messrs. Taraporewala & Sons, Bombay.)* Price Rs. 8.

(5) LAW AND PRACTICE OF INDIAN PRIVATE COMPANIES.

An excellent book of reference and guide to all interested in formation and working of Private Companies with complete reference of decided Indian and English Cases. *(Publishers :—Messrs. Butterworth & Co. (India), Ltd.)* Price Rs. 7-8-0.

(6) BUSINESS ORGANISATION, 3rd EDITION.

A book which all Businessmen, Joint Stock Company Promoters, Managers, Secretaries, Organisers of Industry and Stock Exchange Men should possess for reference and study. It is used by leading Colleges of Commerce and recognised for University as well as other Commercial Examinations. *(Publishers :—Messrs. Butterworth & Co. (India), Ltd.)* Price Rs. 8.

(7) HIGHER ACCOUNTANCY, 3rd EDITION.

For Businessmen, Accountants and Students who have to deal with Accountancy problems, this book will be found to be an excellent media for reference and study. *(Publishers Progressive Corporation, Ltd.)* Price Rs. 8-8-0.

(8) ELEMENTARY THEORY AND PRACTICE OF COMMERCE.

This book is written for the students in High Schools preparing for the Commercial and Technical Diploma Examinations and covers a wide variety of subjects, such as Business Correspondence, Office Routine Work, Postal Services, Bank, Bills of Exchange, Business Transactions, Home and Foreign Trade, Partnership, Joint Stock Companies, Insurance, etc. The Examination Questions, added at the end of appropriate chapters, have been carefully selected. *(Publishers :—Oxford University Press, Bombay.)* Price Rs. 2.

FOREWORD
To the First Edition

BY THE HON'BLE MR. JUSTICE H. J. KANIA, B.A., LL.B., *High Court of Judicature, Bombay.*

I have great pleasure in accepting the invitation of Mr. Davar to write a Foreword to his work on Indian Companies Manual. Mr. Davar is a practising Barrister and has annotated other books. He has been conducting a College of Commerce for many years and has the practical experience of teaching Company Law. He has thus a greater opportunity to appreciate the difficulties in learning this branch of the law. India has been primarily an agricultural country and the growth of industry has been slow. Without the formation of joint stock companies it is difficult to develop the industrial resources of a country and it is only during the last about 30 years that numerous joint stock companies have been formed in India. The law relating to joint stock companies is a matter of special study in England. Owing to the comparatively small number of companies in India this branch of the law, till recently, had not received the careful attention of the lawyers or laymen. With the growth of industry and the consequent increase in the number of companies, the law of joint stock companies has become an important branch of the law of the land. The incident of having managing agents to work a company is peculiar to India.

The effects of this incident on the position of the shareholders and the powers and liabilities of the directors are therefore not to found in the text-books of other countries.

Having regard to this state of development in India Mr. Davar has prepared his Indian Companies Manual. It is not written as a commentary on the Indian Companies Act, section by section, but is written in a style which is useful and instructive to the promoters of a new company and provides easy references to those who desire to know the law relating to a particular branch. For the lawyer, there are sufficient references to make the book useful without being abstruse and over technical. The forms and precedents cover a large field and the index is carefully prepared. The table of cases discloses the industry of the author in considering the numerous cases therein referred to.

I think this attempt to elucidate the complicated working of the Company Law deserves success and appreciation from the lawyers as well as the public.

H. J. KANIA.

High Court,
Bombay, 12-12-34.

PREFACE TO THE SECOND EDITION

THIS edition has been revised and considerably augmented. The extensive amendments made by the Indian Companies (Amendment) Act of 1936 have been dealt with and explained in detail and the new law is printed althroughout the two volumes in *italics* so as to distinguish it from the old. The forms and precedents have been altered wherever necessary in order to meet with the changed requirements of the Act. A large number of new precedents and forms collected from practice have also been added and the case law has been considerably augmented.

In connection with the collection of some of the latest precedents and forms I received very generous assistance from some of my friends in the legal profession. In this connection I must particularly thank Mr. Dinshah K. Daji of Messrs. Payne & Co., Solicitors, Bombay and Messrs. Manekshaw N. Pochkhanawalla and Dorab A. Patel, both of Messrs. Wadia & Ghandi, Solicitors, Bombay, for their courtesy in permitting me the inspection and use of some of the old precedents belonging to their firms.

In conclusion, I also acknowledge the laborious work done in connection with the Index by Mr. D. C. Sutaria, F.C.I.S. (London), Chartered Secretary, an old boy and one of the lecturers of Davar's College of Commerce. The Table of cases was brought up to date by my clerk, Mr. P. K. Mehta, to whom also my acknowledgment is due.

SOHRAB R. DAVAR.

DAVAR'S COLLEGE,
Bombay, 7th July, 1937

TABLE OF CONTENTS

TABLE OF CASES

A

B

C

D

E

G

H

I

J

K

L

M

N

O

Q

R

S

T

W

COMPARATIVE TABLE

COMPARATIVE TABLE

OF

SECTIONS OF THE INDIAN COMPANIES ACT, 1913

WITH

THE OLD ENGLISH COMPANIES (CONSOLIDATION) ACT, 1908

AND

THE NEW ENGLISH COMPANIES ACT, 1929

Sections of the Indian Companies Act, 1913. Amended upto 1936.	Corresponding Sections of the English Companies (Consolidation) Act, 1908.	Corresponding Sections of the English Companies Act of 1929.
1.	*295, 296.*	....
2. (1-5), (7, 10, 12, 14-16)	*285*	380.
2. (8)..........	*108 (5)*..........	131.
2. (13)..........	*121 (1) (2)*.......	26.
3. (3)..........	*131 (7)*..........	163.
4.	*1 (1)*..........	357.
	1 (2)..........	358.
5.	*2*	1.
6.	*3*	2.
7.	*4 (1)*..........	2 (1), (2).
	4 (2)..........	2 (4).
8.	*5*	2 (1), (2).
9. (Modified) 1936	*6*	3. (Without modifications of Ind Act, 1936).
10. (— do. —)	*7*	4. (— do. —)
11. (— do. —)	*8 (1)*..........	17.
	8 (2)..........	19 (2), (3), (4), (5).
12. (— do. —)	*9*	5.
13.	*9 (4)*..........	5.
14.	*9 (5)*..........	5.
15.	*9 (6)*..........	5.
16.	....	....

Sections of the Indian Companies Act, 1913. Amended upto 1936.	Corresponding Sections of the English Companies (Consolidation) Act, 1908.	Corresponding Sections of the English Companies Act of 1929.
17.	*10* (*1*), (*2*)......	6.
	10 (*3*), (*4*)......	8 (1).
18. (Modified) 1936	*11*	8 (2).
19.	*12*	9.
20.	*13* (*1*)...........	10.
	13 (*2*)...........	319 (2).
20A. (New Section) 1936	....	22.
21.	*14*	20.
22.	*15*	12.
23.	*16*	13, 14.
24.	*17*	15.
25. (Slightly Modified) 1936	*18*	23.
	19	14.
25A. (Newly added)	....	24.
26.	*20*	18.
27.	*21*	21.
28.	*22*	62.
29.	*23*	68.
30.	*24*	25.
31.	*25*	95.
31A. (Newly added)	....	96.
32. (Considerably Modified) 1936	*26* (*1*), (*2*).......	108.
	26 (*4*), (*5*).......	110, 111.
33.	*27*	101.
34. (Considerably Modified) 1936	*28*	65.
35.	*29*	64.
36. (Modified) 1936	*30* (*2*), (*3*).......	98.
37. (Slightly Modified) 1936	*31*	99.
38.	*32* (*4*)	100.
39. (Slightly Modified) 1936	*32*.	
40.	*33*	102.
41.	*34*	103.

Sections of the Indian Companies Act, 1913. Amended upto 1936.	Corresponding Sections of the English Companies (Consolidation) Act, 1908.	Corresponding Sections of the English Companies Act of 1929.
42.	*35*	104.
....	*36*	105.
43. (Slightly Modified) 1936	*37* (*1*)	70.
44.	*37* (*2*)	
45.	*37* (*3*)...........	97 (2).
46.	*37* (*4*)...........	70, 141 (2).
47.	*37* (*5*)...........	97.
48.	*37* (*6*)...........	....
....	*38*	71.
49.	*39*	48.
....	*40*	....
50. (Slightly Modified) 1936	*41*	50.
51.	*42*	51.
52.	*43*	52, 95.
53. (Slightly Modified) 1936	*44*	7, 52, 86.
54.	*45*	....
54A. (New Section) 1936	....	....
55.	*46*	55.
56.	*47*	56.
57.	*48*	....
58.	*49*	56.
59.	*49* (*3*)	
60.	*60*	57.
61.	*51*.	58.
62.	*52*	
63.	*53*	59.
64.	*54*	60.
65.	*55*	57 (2b).
66.	*56*	50, 55.
66A. (New Section) 1936	....	61.
67.	*57*	16.
68.	*58*	53.
69.	*59*	49.
70.	*60*	146.
71. (Slightly Modified) 1936	*61*	147.

Sections of the Indian Companies Act, 1913. Amended upto 1936.	Corresponding Sections of the English Companies (Consolidation) Act, 1908.	Corresponding Sections of the English Companies Act of 1929.
72. (Considerably Modified) 1936	*62*	92.
73.	*63*	93.
74.	*63 (2)*	
75.	....	....
76. (Considerably Modified) 1936	*64*	112.
77. (— do. —)	*65*	113.
	65 (9)...........	171.
78. (Slightly Modified) 1936	*66*	114.
79.	*67*	115.
80.	*68*	116.
81. (Considerably Modified) 1936	*69*	117.
82. (Slightly Modified) 1936	*70*	118.
83. (Considerably Modified) 1936	*71*	120.
83A. (Modified) 1936	....	....
83B. (— do. —)	....	....
84. (Modified) 1936	*72*	140.
85.	*73*	141.
86.	*74*	143.
86A. (New Sections) 1936	....	142.
86B.	....	....
86C.	....	....
86D.	....	....
86E.	....	....
86F.	....	....
86G.	....	....
86H.	....	....
86I.	....	....
87. (Redrafted) 1936	*75*	144.

Sections of the Indian Companies Act, 1913. Amended upto 1936.	Corresponding Sections of the English Companies (Consolidation) Act, 1908.	Corresponding Sections of the English Companies Act of 1929.
87A. (New Sections) 1936	....	....
87B. (New Sections) 1936	....	....
87C. (New Sections) 1936	....	....
87D. (New Sections) 1936	....	....
87E. (New Sections) 1936	....	....
87F. (New Sections) 1936	....	....
87G. (New Sections) 1936	....	....
87H. (New Sections) 1936	....	....
87I. (New Sections) 1936	....	....
88.	*76*	29.
89.	*77*	30.
90.	*78*	31.
91.	*79*	32.
91A. (Slightly Modified) 1936	....	....
91B. (— do. —)	....	....
91C. (— do. —)	....	....
91D. (— do. —)	....	....
92.	*80*	34.
93. (Considerably Modified) 1936	*81.*	35, 355.
94.	*81* (*2*).	35, 355.
95.	*81* (*3*).	35, 355.
96. (Modified) 1936	*81* (*4*).	35, 355.
97. (Considerably Modified) 1936	*81* (*6*).	35, 355.
98.	*82*	40.
98A. (New Section) 1936	....	38.
99.	*83*	36.
100.	*84*	37.
101. (Considerably Modified) 1936	*85*	39.
102. (Slightly Modified) 1936	*86*	41.
103.	*87*	94.
104.	*88*	42.
105.	*89*	43.
105A. (New Section) 1936	....	47.

Sections of the Indian Companies Act. 1913. Amended upto 1936.	Corresponding Sections of the English Companies (Consolidation) Act. 1908.	Corresponding Sections of the English Companies Act of 1929.
105B. (New Section) 1936	....	46.
105C. (— do. —)	....	....
106.	*90*	44.
107.	*91*	54.
108.	*92*	67.
109.	*93.*	79. 80 (1). (2). 81. 82 (1), (3), 83 (1), 87.
109A. (New Section) 1936	......	
110.	*93 (3).*	
111.	*93 (4).*	
112.	*93 (2).*	
112. (3)...........	*93 (8).*	
113.	*98*	82.
114.	*93 (5).*	79, 80 (1), (2), 82 (1), (3), 83 (1), 87.
115.	*93 (6).*	
116.	*93 (7).*	
117.	*93 (9).*	
118.	*94*	86.
119. (Considerably Modified) 1936	*95*	310.
120. (— do. —)	*96*	85.
121. (Redrafted) 1936	*97*	84.
....	*98*	82.
122. (Modified) 1936	*99*	80, 83.
123. (Slightly Modified) 1936	*100*	88.
124.	*101*	89.
125.	*102*	73.
126.	*103*	74.
127.	*104*	75.
128.	*105*	76.
....	*106*	77.
129.	*107*	78.
130. (Redrafted) 1936	....	122.
131. (1)...........	....	123 (Partially).
131. (2) (Slightly Modified) 1936	*113 (3)*...........	129, 130.

Sections of the Indian Companies Act, 1913. Amended upto 1936.	Corresponding Sections of the English Companies (Consolidation) Act, 1908.	Corresponding Sections of the English Companies Act of 1929.
131A. (New Section) 1936	....	123 (2).
132.	*26 (3)*...........	....
132A. (New Section) 1936	....	126 (Considerably Modified).
133. (1)...........	*113 (5) (b)*.......	129.
133. (2)...........	....	....
133. (3)...........	*113 (4)*...........	129.
134.	*26 (4)*...........	110.
135. (Slightly Modified) 1936	*113 (3)*...........	129. 130.
136. (— do. —)	*108*	131.
137. (Considerably Modified) 1936	....	....
138.	*109.*	135.
139.	*109 (2)*	135.
140.	*109 (3)*	135.
141. (Modified) 1936	*109 (6)*	135.
141A. (New Section) 1936	....	Based on **136.**
142.	*110*	137.
143.	*111*	138.
144. (3) *et seq.* (Slightly Modified) 1936	*112 (3)*........... *(6), (7)*.......	132.
	112 (1), (2), (4)	133.
145. (Modified) 1936	*113*	129. 130.
	113 (1), (2), (5)	134.
146. (— do. —)	*114*	130.
147.	*115*	28.
148.	*116*	370.
149.	....	....
150.	*117*	33.
151.	*118*	11, 14, 108, 379.
152.	*119*	....
153. (Considerably Modified) 1936	*120*	153.

Sections of the Indian Companies Act, 1913. Amended upto 1936.	Corresponding Sections of the English Companies (Consolidation) Act, 1908.	Corresponding Sections of the English Companies Act of 1929.
153A. (New Section) 1936	....	154.
153B. (— do. —)	....	155.
154. (Redrafted) 1936	*121* (2)..........	27.
155.	*122*	156.
156.	*123*	157.
157.	*123* (2).	
158.	*124*	158.
159. (Modified) 1936	*125*	159.
160. (— do. —)	*126*	160.
161.	*127*	161.
....	*128*	162.
162.	*129*	168.
163. (Modified) 1936	*130*	169.
164.	....	....
165.	....	....
....	*131* (3)-(7)........	163.
....	*132*	164.
....	*133*	165.
....	*134*	....
....	*135*	....
....	*136*	167.
166. (Modified) 1936	*137*	170.
167.	*138*	178.
168.	*139*	175.
169.	*140*	172.
170. (Modified) 1936	*141*	171.
171.	*142*	177.
171A. (New Section) 1936	....	....
172. (Modified) 1936	*143*	176.
173.	*144*	202.
174.	*145*	288.
....	*146*	179.
....	*147*	181.
....	*148*	182.

Sections of the Indian Companies Act, 1913. Amended upto 1936.	Corresponding Sections of the English Companies (Consolidation) Act. 1908.	Corresponding Sections of the English Companies Act of 1929.
175. (Slightly Modified) 1936	*149 (1)*...........	183.
	149 (2), (3a)......	184.
	149 (3b), (7), (9a)	185.
	149 (3c), (8)......	186. 188.
	149 (4)...........	188 (4).
176. (— do. —)	*149 (6)*...........	188.
177.	*149 (9)*...........	185.
177A. (New Section) 1936	....	181.
177B. (— do. —)	....	182.
178. (Modified) 1936	*150*	189.
178A. (New Section) 1936	....	199.
	151	191.
179.	*151 (4)*	184.
180.	151 *(5)*	184.
181.	*151 (1d)*	184.
....	*152 (1), (1b), (2), (3).*	185, 198.
....	*152 (1)-(4), (6)*...	186.
....	*153*	186.
....	*154*	194.
....	*155*	195.
182. (Modified) 1936	*156*	193. 195.
....	*157*	197.
183. (Modified) 1936	*158*	192.
....	*159*	196.
....	*160 (1)-(8)*.......	199.
....	*160 (9)*...........	200.
....	*161*	209.
....	*162*	307.
184.	*163*	203.
185.	*164*	204.
186.	*165*	205.
187.	*166*	206.
188. (Slightly Modified) 1936	*167*	207.
189. (— do. —)	*167 (2)*	207.
190.	*168*	208.
191.	*169*	210.
192.	*170*	211.
193.	*171*	213.
194.	*172*	221.

Sections of the Indian Companies Act, 1913. Amended upto 1936.	Corresponding Sections of the English Companies (Consolidation) Act, 1908.	Corresponding Sections of the English Companies Act of 1929.
....	*173*	220.
195.	*174*	214.
196.	*175*	216.
197.	*176*	218.
198.	*177*	219.
199.	*178* (*1*), (*2*).......	163, 373.
....	*179*	222.
200.	*180* (*2*)	223.
201.	*180* (*3*)	
202.	*181* (*2*)-(*4*)........	224.
203. (Slightly Modified) 1936	*182*	225.
204. (— do. —)	*183*	227.
205.	*184*	228.
206.	*185*	226.
207. (Redrafted) 1936	*186*	
208. (— do. —)	*187*	
208A. (New Section) 1936		
208B. (— do. —)		
208C. (— do. —)		
208D. (— do. —)		
208E. (— do. —)		
209. (Redrafted) 1936	*188*	
209A. (New Section) 1936		
209B. (— do. —)	....	230 to 255 (inclusive).
209C. (— do. —)		
209D. (— do. —)		
209E. (— do. —)		
209F. (— do. —)		
209G. (— do. —)		
209H. (— do. —)		
210. (Redrafted) 1936	*189*	
211. (— do. —)	*190*	
212. (— do. —)	*191*	
213. (— do. —)	*192*	
214. (— do. —)		
215. (— do. —)	*193*	
216. (— do. —)	*194*	
217. (— do. —)	*195*	
218. (— do. —)	*196*	

Sections of the Indian Companies Act, 1913. Amended upto 1936.	Corresponding Sections of the English Companies (Consolidation) Act, 1908.	Corresponding Sections of the English Companies Act of 1929.
219. (Omitted) 1936	*197*	255.
220.	*198*	175.
221.	*199*	256.
222.	*200*	257.
223.	*201*	288.
224.	*202*	259.
225.	*203*	260.
226.	*204*	187 (3).
227.	*205*	173, 229, 258.
228.	*206*	261.
229.	*207*	262.
....	*208*	....
230. (Modified) 1936	*209*	264.
230A. (New Section) 1936	....	267.
231.	*210*	265.
232. (Slightly Modified) 1936	*211*	174, 258.
233.	*212*	266.
....	*213*	270.
234.	*214*	191, 248, 260.
235. (Modified) 1936	*215*	276.
236.	*216*	272.
237. (Redrafted) 1936	*217*	277.
238.	*218*	363.
238A. (New Section) 1936	....	271.
239.	*219*	288.
240.	*220*	282.
241.	*221*	212.
242.	*222*	283.
243.	*223*	294.
244. (Modified) 1936	*224*	284.
	224 (4)-(7).......	285.
....	*225*	289.
....	*226*	290.
....	*227*	291.
244A. (New Section) 1936	....	194.
245.	*228*	293.

Sections of the Indian Companies Act, 1913. Amended upto 1936.	Corresponding Sections of the English Companies (Consolidation) Act, 1908.	Corresponding Sections of the English Companies Act of 1929.
246. (Slightly Modified) 1936	*173*	220.
....	*229*	300.
....	*230*	301.
....	*231*	302.
....	*232*	....
....	*233*	303.
....	*234*	....
....	*235*	304.
....	*236*	378.
....	*237*	305.
....	*238*	374.
....	*239*	297.
....	*240*	298.
....	*241*	299.
247.	*242*	295.
....	*243*	....
248.	*243 (1)-(5), (8)* } ... *243 (6), (7)*	312, 314.
249.	*244*	313.
249A. (New Section) 1936	....	135.
250.	*245*	316.
251.	*246*	317.
....	*247*	318.
252.	*248*	319.
253.	*249*	321.
254.	*250*	322.
....	*251*	360.
255.	*252*	323.
256.	*253*	324.
257.	*254*	325.
258.	*255*	326.
259.	*256*	359.
260.	*257*	327.
261.	*258*	328.
262.	*259*	329.
263.	*260*	330.
264.	*261*	331.
265.	*262*	332.
266.	*263*	333.
267.	*264*	334.
268.	*265*	335.
269.	*266*	336.
270.	*267*	337.

Sections of the Indian Companies Act, 1913. Amended upto 1936.	Corresponding Sections of the English Companies (Consolidation) Act, 1908.	Corresponding Sections of the English Companies Act of 1929.
271. (Modified) 1936	*268*	338.
272.	*269*	339.
273.	*270*	340.
274.	*271*	341.
275.	*272*	....
276.	*273*	342.
277. (Modified) 1936	*274*	343, 344, 346, 348, 349, 35[illegible], 352.
277A. (New Section) 1936	....	354.
277B. (— do. —)	....	355.
277C. (— do. —)	*90*	....
277D. (— do. —)	....	....
277E. (— do. —)	....	....
277F. (— do. —)	....	....
277G. (— do. —)	....	....
277H. (— do. —)	....	....
277I. (— do. —)	....	....
277J. (— do. —)	....	....
277K. (— do. —)	....	....
277L. (— do. —)	....	....
277M. (— do. —)	....	....
277N. (— do. —)	....	
278.	....	
....	*275*	345.
....	*276*	366.
279.	*277*	367.
280.	*278*	371.
281. (Redrafted) 1936	*279*	372.
....	*280*	375.
282.	*281*	362.
282A. (New Section) 1936	....	....
282B. (New Sections) 1936	....	....
283.	*282*	364.
....	*283*	376.
....	*284*	377.
....	*285*	380.
....	*286*	....
284.	*287*	....
285.	*288*	....
286.	*289*	....

Sections of the Indian Companies Act, 1913. Amended upto 1936.	Corresponding Sections of the English Companies (Consolidation) Act, 1908.	Corresponding Sections of the English Companies Act of 1929.
287.	293	....
288.	....	....
289.	....	....
290.	286	....

INDIAN COMPANIES MANUAL

WITH

SECRETARIAL PRACTICE, FORMS AND PRECEDENTS.

CHAPTER I.

Companies in General

Early History of Companies

Joint Stock Companies in England formed for trading and other purposes date back for several centuries. The original East India Company was established in 1600 A.D., by the grant of a Charter by Queen Elizabeth Its business was that of financing the Government with the carrying on of its own trade. The Hudson Bay Company was founded in 1670 A.D., under a Royal Charter. The Bank of England was established in 1694 A.D., under a Royal Charter to finance the Government of William III. These Companies were all formed either through the grant of a Royal Charter, or by special Acts of Parliament, whereas incorporation under the ordinary Companies Act, so familiar to us in these days, was not introduced until 1844. Incorporation on the limited liability principle was not allowed until the year 1855. In the year 1862, the Company Law of England was properly codified, and during subsequent years frequently modified. In the year 1908, however a Consolidation Act was passed called the Companies (Consolidation) Act of 1908, which practically represented the Company Law of India (with slight amendments) as represented by the Indian Companies Act of 1913.

In the year 1929, a New Companies Act was passed in England which came into operation on 1st November 1929. This Act was a consolidating measure which incorporates the provisions of the Act of 1928 which this New Act repeals.

In India the Acts passed from time to time may be briefly stated as follows :—

Joint Stock Companies Act 1850 (Repealed by the Act of 1866).

Joint Stock Companies Act 1857 (Repealed by the Act of 1866).

Joint Stock Banks Act 1860 (Repealed by the Act of 1866).

Companies Act 1866 (Repealed by the Act of 1882).

Companies Act 1882 (Repealed by the Act of 1913).

Companies Amendment Act 1887 (Repealed by the Act of 1913).

Companies (Memorandum of Association) Act 1895 (Repealed by the Act of 1913).

Companies (Branch Registers) Act 1900 (Repealed by the Act of 1913).

Companies Amendment Act 1910 (Repealed by the Act of 1913).

Companies Act 1913. Amended by the Act of 1914.

Indian Companies (Amendment) Act 1936.

The Act of 1882 was practically speaking the standard Act for India, of course with amendments indicated above, until its repeal by the Act of 1913. The object with which the Act of 1913 was passed was to consolidate and amend the law relating to Trading Companies and other Associations. In the drafting of this Indian Companies Act of 1913 the English Act of 1908 has no doubt been taken as the model, the sections of which are bodily incorporated in the Indian Act. The Act of 1913, however, thus consolidated, is a drastic amendment of the Indian Companies Act as in force at the time, particularly by way of additions, as the same had fallen quite behind the time owing to the rapid

strides made by Company legislation in England during the intervening years. Besides incorporating the various sections of the English Act of 1908, with additions and alterations, the Indian Act of 1913 included provisions which distinctly gave it a step in advance of its English contemporary, particularly in regard to provisions for the order of inspection into the affairs of the company by the local Government at the instance of the share-holders where, in the opinion of the Registrar of Companies, a sufficient case has been made out for the same and also as regards the qualification of auditors.

The Indian Company organisation however recorded a rapid progress between the years 1913 and 1936 and the demand for bringing the Indian Companies Act up-to-date through amendments brought about after careful investigation of the question became more persistent, with the result that the amendment of the Act was taken in hand in the year 1936. After the investigation of the problems first through a Special Law Officer appointed for the purpose and latterly through a careful survey of the whole problem from purely Indian standpoint by a Special Committee appointed by the Government of India which was representative of all interests the draft bill was introduced and passed in the two houses. The new Bill which as we have seen above is known as the Indian Companies (Amendment) Act of 1936, makes substantial alterations and additions to the old Act of 1913. For the first time in the history of Indian Company legislation the managing agent has been defined and his powers, as well as limitations, provided for within its sections. The subsidiary and parent companies are now defined and their organisation and working are brought within the perview of the Act by relevant sections which in some particulars happen to go further even from the sister English legislation in view of the experience of the working of that legislation since the year 1929 when the English Act was passed. The Law applying to the meetings of shareholders or members has also received careful consideration in the course of these

amendments. There is also a well-thought-out alteration of law applying to the formation and working of the Boards of Directors and their Constitution. The minimum subscription is now placed on more or less similar basis to the English Act of 1929. In connection with Account keeping also it is now made compulsory to circulate a Profit and Loss Account displaying certain specified items of revenue and expenditure along with the Balance Sheet and the directors report as to the state of the company's affairs before the periodical meetings of the company, as provided for in S. 131. The Form F of the Balance Sheet has also been considerably modified.

Voluntary Winding up is now divided into two divisions, *viz.*, the Members' Voluntary Winding up and the Creditors' Voluntary Winding up, more or less along the lines of the English Act of 1929 and the old Act has been considerably modified in this connection.

Banking Companies are now given a special chapter in the Act embracing special sections applying to joint stock companies doing banking business in India. A Banking Company has now been elaborately defined in a special section.

All round speaking, the New Amending Act of 1936 has considerably modified the old legislation which is bound to exercise a very healthy influence on Indian Company Organisation of the future and check if not absolutely eradicate various abuses which had become so notorious under our company system of management.

There are, of course, companies specially formed by or under Special Acts of Parliament in England, or under the Special Acts of the Councils in India. Besides, there are Acts specially applying to special classes of companies, such as Railway or Life Insurance Companies. This treatise is restricted to the treatment of the Law bearing on companies formed under the Indian Companies Act of 1913 as amended by the Amending Act of 1936.

Prior to the passing of the English Act of 1862, large partnerships used to be formed known as " Unincorporated

Companies." Such companies cannot now exist, as the modern Acts make it compulsory for all partnerships made up of more than twenty persons carrying on trading business or more than ten carry on banking business, to be incorporated under the Indian Companies Act 1913. In the absence of such incorporation they would be classed as "illegal partnerships."

THE COMPANY SECRETARY

The "Company Secretary" has come into prominence as a Specialised Officer with specialised training in Company Law and Practice with a view to efficiently look after the Secretarial Work in connection with Joint Stock Companies. The word "Secretary" is derived from the Latin word "Secretarius," which means a notary or scribe. In early days it was employed in connection with secretaries privately employed by Ministers of State. Thereafter it has extended to Secretaries of Embassies and Legations. Private individuals with large estates and other interests thereafter began to employ Secretaries. Ultimately, with the advent of Joint Stock Companies on the scene and their development in large dimensions, brought in a specialised officer of the type we have referred to above who is now known as the Secretary of a Joint Stock Company. This Manual being a specialised volume dealing on Joint Stock Companies, their Practices, the Law applying to them, as well as, Regulations, Forms and Precedents we are naturally interested in the officer known as the Secretary of Joint Stock Companies. There are, now-a-days, avenues for Specialised Education for Company Secretaries with two prominent Professional Boards of England, each of which has formulated syllabuses exacting a very high standard of knowledge, *viz.*, (1) the Chartered Institute of Secretaries of London with which is now amalgamated the Incorporated Secretaries Association of London and (2) the Corporation of Certified Secretaries of England. No doubt, the Secretary is the mouthpiece of the Board and has to carry out commands and orders of

the Board of Directors, but in connection with technical incidents of company practice, as well as the grappling with problems of Company Law, it is he who generally guides the board of directors. An able Secretary, who wins over confidence of the Board, exercises considerable influence on the Directors. This is particularly so in India where the "Managing Agents" frequently assume the garb of Secretaries under the title of "Secretaries, Treasurers, and Agents." Usually the Managing Agency Firms employ a secretary who is attached to one or more of the companies under their management. The Managing Agents as such are now specifically defined under the Indian Companies (Amendment) Act 1936 and receive a special treatment in the Act as to their rights, duties and obligations which have been fully dealt with hereafter. The Secretary here is a full-time salaried officer, who looks after the secretarial work of the company to which he is attached. His position naturally is most confidential, as he is continuously in close touch with the work of the Board of Directors. The selection of this important official forms one of the principal steps in the early organisation of a company. The choice should fall on an expert with special training and experience in company work and practice, with a wide range of specialised knowledge in general affairs. He should also be able to control a large number of men, specialists as well as the general office staff, and should possess an impressive personality. As he has to look after the general correspondence, sales and purchases, he should be able to handle these departments of work efficiently and should possess some particular knowledge of the class of goods the company is dealing in. He should above all be a man of honour and integrity who is not likely to use his official position or knowledge as to the internal working of the company, to his own advantage or to those of his friends and relatives.

The following is a summary of the Duties of a Secretary under two different headings, namely, (1) at

and before the Incorporation of the Company and (2) after Incorporation of the Company.

I. Duties at and before Incorporation

1. To attend at all preliminary meetings convened and when required, keep a record of proceedings of these meetings and help in the discussion and preparation of the Prospectus.

2. To see that all requirements of the Act as to incorporation and registration are carried out and the proper documents are being filed. After incorporation to call the first meeting of the board and get the necessary resolutions passed in connection with the election of chairman if not so appointed by the articles, appointment of Secretary, Manager, Accountant and other responsible officers, the disposal of the Incorporation Certificate and opening of bank accounts, the signature on cheques and other important documents, etc.

3. To see that his own appointment is made and confirmed in a proper form by a proper resolution at the first meeting of the board.

4. The appointment of various Sub-Committees, such as the Transfer Committee, the Finance Committee, Works Committee, etc., and to regulate by bye-laws and other media the further conduct of the business of the Company.

5. To obtain at the earliest opportunity a certificate entitling the company to commence business by filing the necessary papers and documents.

6. To get and make preparation within the time appointed and call the Statutory Meeting as well as get the Statutory Report prepared in due form.

II. Duties after Incorporation

1. To make himself thoroughly conversant with the contents of the memorandum and articles of association, as well as the regulations fixed by the Board at its yearly meetings.

2. To call meetings of directors, committees and members at intervals fixed by regulations, or otherwise, and get the proceedings of same recorded in proper minute books with proper divisions and indexes.

3. To look after the secretarial correspondence and exercise general supervision over the affairs of the company, particularly those falling within the sphere of the secretarial department, and in small companies, also to look after the details of management, accounts, etc.

4. To see that proper documents are sealed according to the regulations, in the presence of the required number of directors—under his own counter-signature, as may be laid down by the regulations.

5. To look after the incidents of applications, allotments, and calls on shares and debentures, as well as forfeiture of shares and to see that the procedure as laid down by the regulations is strictly adhered to and followed.

6. To see that all documents are properly stamped and filed according to the requirements of the Companies Act.

There is, of course, no objection in Law as to one person acting as a Secretary to a number of companies, but from the point of view of efficient organization, unless the companies concerned are really part of one combination, this is not desirable.

The practice which at present prevails in India under which one Managing Agency Firm undertakes the direction of a number of companies has been criticised on this ground, but of course so much depends on the organization and the ability of the members of such Agency Firms and their officers that every case has of necessity to be judged on its merit in this connection.

Legal Position of the Secretary

As far as India is concerned, the exact legal position of Managing Agents who also Act as Secretaries largely depends on the agreement made between the Agency Firm and the Company, which agreement, generally embraces

multifarious rights, powers and duties. With regard to a salaried Secretary, his position is laid down in two leading cases in England, *viz.*, [*Newlands* v. *National Employment Accident Association*, (1885) 54 *L. J. Q. B.* 428 *and Barnett, Hoares* v. *South London Tramways*, (1887) 18 *Q. B. D.* 815]. In both these cases, *Lord Esher, M.R.*, enunciated the same doctrine, *viz.*, that "a Secretary is a mere servant. His position is that he is to do what he is told, and no person can assume that he has any authority to represent anything at all; nor can anyone assume that the statements made by him are necessarily to be accepted as trustworthy, without further inquiry, any more than in the case of a merchant it can be assumed that one who is only a clerk has authority to make representations to induce persons to enter into contracts." To put it briefly, the Secretary as such has no status or power given by law but the scope of his duties and rights is laid down by the agreement if any made between him and the company, the Articles of Association and the resolutions of directors. In short, *prima facie* the Secretary has no authority to bind the Company by contracts (*Williams* v. *Chester and Holyhead Ry. Co.*, (1851) 15 *Jur.* 828), nor can be strike the name off, of a member from the Register of Members (*Indo-China Steam Navigation Co.*, (1917) 2 *Ch.* 100, see also *Wheatcrofts' Case*, (1873) 29 *L. T.* 324); nor to commence proceedings in a suit in the name of the Company (*Daimler Co.* v. *Continental Tyre and Rubber Co.*, (1916) 2 *A. C.* 307); nor can he make a binding admission for the Company (*Bruff* v. *Great Northern Ry. Co.*, (1858) 1 *F. & F.* 344). Generally speaking, he can send out notices according to directions of the Board of Directors, attend to general correspondence and particularly to correspondence relating to filing of returns with Registrar of Companies or what is known as secretarial correspondence, to look to transfers, and attend all meetings of the directors, shareholders and creditors and maintain proper minute books as well as company books relating to shares and their transfers (*Cairney* v. *Back*,

(1906) 2 *K. B.* 746; *Betts* v. *Macnaghten* (1910) 1 *Ch.* 430).

In smaller companies the Secretary has the duties of management, etc., thrown upon him in addition to his usual secretarial duties.

It has been held that a compulsory winding up terminates without notice the Secretary's contract of service in common with all servants and therefore constitutes a wrongful dismissal. (*In re Theatrical Trust (Chapman's Case)*, (1895) 1 *Ch.* 771). A resolution for voluntary winding up may in some cases operate as a dismissal of the company's services. The principle is that if the consequence of the liquidation is that the company is going out of business altogether the liquidation operates as a termination of the Secretary's appointment; but if the company is reconstructing with a view to continue business and employ former servants it would not. (*Reigate* v. *Union Manufacturing Co.*, (1918) 1 *K. B.* 592; *Midland Counties Bank*, v. *Attwood,* (1905) 1 *Ch.* 357).

In case of the appointment of a Receiver for the Debenture-holders who is to be debenture-holders' agent the appointment of the Secretary also terminates but not if the Receiver is to act as an agent of the Company (*Reid* v. *Explosives Co., Ltd.*, (1887) 19 *Q. B. D.* 264).

In all these cases of termination, the Secretary can bring an action for damages on the footing of wrongful dismissal. The damages would naturally arise where there is a contract for service for a fixed period which had not expired on the date of winding up. When the agreement is clear as to the period of employment, the Court will not imply that the employment was terminable on discontinuation of the business by the Company (*Turner* v. *Goldsmith,* (1891) 1 *Q. B.* 544; *Reigate* v. *Union Mfg. Co.,* (1918) 1 *K. B.* 592; *Fowler* v. *Commercial Timber Co.,* (1930) 2 *K. B. I.*). Of course, if there is no definite term of employment the Court will not imply a term (*Rhodes* v. *Forwood,* (1876) 1 *App. Cas.* 256; *Railway and*

Electric Co., (1888) 38 *Ch. D.* 597; *Hamlyn and Co.* v. *Wood*, (1891) 2 *Q. B.* 488). The actual damages to be paid would depend upon the actual loss likely to be suffered and a clause of the agreement fixing the amount of damage would not be a guide. (*Re* : *W. R. Snow and Co., Ltd.*, (1930) *W. N.* 68; *Re* : *Gramophone Records Ltd.*, (1930) *W. N.* 42). If the agreement provides that the secretary or any other employee should not carry on a competing business, such a provision would cease to apply where the company through going into winding up disables itself from continuing business (*Measures Bros. Ltd* v. *Measures*, (1910) 2 *Ch.* 248).

In case where the wrongful dismissal arises through a compulsory liquidation the Secretary or Servant must get the sanction of the Court before a suit is filed (S. 171). In case there is no separate contract of service, but the articles refer to same on which his rights exclusively depend, the secretary can claim remuneration up to the date of the winding up and cannot claim damages for loss of employment after the date of the winding up (*Dale and Plant* (1889) 1 *Meg.* 338; 61 *L. T.* 206). A Secretary cannot claim any loss on the books and papers of the Company for the arrears of remuneration due to him from the Company (*Barnton Hotel* v. *Cook*, (1899) 1 *Fra.* 1190).

It has also been held that the knowledge of Directors is in the ordinary circumstances the knowledge of the company, but the knowledge of a mere official such as the Secretary, would only be the knowledge of a company if the thing of which the knowledge is secured is a thing within the ordinary domain of the Secretary's duties. (*Houghton & Co.* v. *Nothard Low & Wills*, (1928) *A. C.* 1). However, it has been held that where the same person is the Secretary of two companies, knowledge acquired by him for one company is not notice to the other. (*Fenwick, Stobart & Co.*, (1902) 1 *Ch.* 507; (*Evans* v. *Employers Mutual Insurance Association Ltd.*, (1936) 1 *K. B.* 505) where it was held that knowledge of a sub-officer is knowledge of the company if delegated the duty

of investigating. As to the acts of a Secretary done within the scope of his authority, it has been laid down that the principal (*i.e.* the company) is liable for the fraud of the secretary acting within the scope of his authority whether the fraud is committed for the benefit of the principal or for the benefit of the agent. (*Lloyd* v. *Grace Smith & Co.,* (1912) *A. C.* 716). It has got to be carefully seen, whether the particular act done, or the particular thing said was within the scope of the duty of the secretary or within the scope of authority given to him by the Board of Directors. In one case where a letter was written by the Secretary which purported to confirm the arrangement not otherwise ratified by his company it was held that the same was not binding on the company. (*Houghton & Co.,* v. *Nothard Low and Wills,* (1928) *A. C.* 1.) The position *prima facie* of the Secretary is not fiduciary (*Municipal Freehold Land Co.,* v. *Pollington,* (1890) 63 *L. T.* 238). The offices of a director and secretary are so imcompatible that one and the same person cannot hold both (*Ironship Coating* v. *Blunt,* (1868) *L. R.* 3 *C. P.* 484; *Boschok Proprietary* v. *Fuke,* (1906) 1 *Ch.* 148). The Secretary generally speaking is not liable for the acts of the board of directors unless he has actively intermeddled with same (*Municipal Freehold Land Co.* v. *Pollington,* (1890) 63 *L. T.* 238).

The principle that outsiders are not bound to inquire whether the arrangements prescribed by the Articles of Association are carried out in the internal management, applies only to directors and not to branch managers, or other officials, such as the Secretary as laid down in the *Houghton & Co.'s* case cited above. The doctrine also does not apply to a forged document. (*Ruben* v. *Great Fingall Consolidated,* (1906) *A. C.* 439). See also (*Kredit Bank Cassel* v. *Schenkers,* (1927) 1 *K. B.* 826). In case where one person or firm acts as Secretary of two companies, the notice to that person as Secretary of one company will not operate as a notice to the other company also entitled to such a notice. (*Re Fenwick, Stobart & Co.,*

(1902) 1 *Ch.* 507). If that is not so, the Secretary himself will be personally liable. The Secretary is, of course, one of the officers liable to penalties for not doing various acts or for failing to file various returns prescribed by the Indian Companies Act, 1913, as we shall see in subsequent Chapters. The secretary is also one of the officers of the company who is liable to be examined in winding up under S. 196 of the Indian Companies Act, 1913, as one of the officers of the company. He is also primarily responsible if he wilfully makes a statement false in any material particular or is in any way guilty of destroying or mutilating books. (S. 235-236-282-282A-282B). Misrepresentations made by the Secretary binds a company if the same are made in the course of his duty. In case the Secretary receives secret commission he is liable to account to the company for the money on the same principle as an agent receiving secret commission is liable to account to the principal. In signing Bills of Exchange or any document on behalf of the company in the regular course of his office, the Secretary should see that he signs for and on behalf of the company in his official capacity as a Secretary, as otherwise, he would be personally liable on the document. The correct form of signature of a Secretary is :—

For the Bombay Trading Co., Ltd.,
ROBERT GREEN,
Secretary.

When there is no contract by the company as to the term of his office, he like an ordinary servant is entitled to be given a reasonable notice. As an important officer he is entitled to a notice of six months in the usual course if he has been in the service for a long period, if not about three months' notice would be sufficient. (*African Association, Ltd. and Allan* (1910) 1 *K. B.* 396). Where a Receiver has been appointed under the Debenture Trust Deed under powers reserved in same, as distinguished from the Receiver appointed by the Court, that appointment

in itself does not terminate the contracts with the servants of the company. Here of course, the Receiver was not an officer of the Court, but an Agent of the Debenture Holders. (*Robinson Printing Co., Ltd.* v. *Chic, Ltd.*, (1905) 2 *Ch. Page* 123).

Statutory and other Liability of the Secretary

From the list of returns to be filed with the Registrar of Companies given in the Appendix A, it will be noticed that, a large number of returns have to be filed with the Registrar of Joint Stock Companies by the Secretary on behalf of the company and if he fails to do so, not only he himself is liable to various penalties imposed, but also the directors and other officers become liable for same. Besides these, under the general Law the Secretary is responsible as an officer of the company in fiduciary relation to it for misfeasance or secret commission or any improper act or negligence of which he may be guilty. (*Barrow's Case Re Stapleford Colliery Co.*, (1879) 28 *W. R.* 341). He is not liable or accountable, as the directors are, for loss which may be incurred by the company by reason of any mis-application of funds of the company even with his knowledge, unless the said mis-application was due to his own fraud or negligence. (*Joint Stock Discount Company* v. *Brown*, (1869) 8 *Eq.* 381).

A List of Returns

For returns of Documents to be filed with the Registrar of Joint Stock Companies together with Penalties for Default, see Vol. II Appendix A and Index.

Prohibition of large Partnerships

The Indian Companies Act, S. 4, restricts or prohibits partnerships being formed of more than 10 in Banking Business and more than 20 in any other business. Where four Marwari firms of more than twenty individuals formed a syndicate and entered into contracts with a view

to divide profits it was held to be an illegal partnership as the transaction was not confined to a single venture (*Pannaji Devichand* v. *Senaji Kapurchand*, (1934) 36 *Bom. L. R.* 786). It is further enacted by Indian Companies (Amendment) Act 1936 that this section shall not apply to a joint family carrying on joint family trade or business. This wording makes it clear that it may be any joint family irrespective of whether it is a Hindu, Mohamedan, Parsi, or any other communal family. If however two or more such joint families form a partnership, in computing the number of persons for the purposes of this section minor members of such families shall be excluded. This means that where two or more trading families form a partnership the limitation as to membership as provided for in the section 4 will apply, but with the reservation that minor members of such families shall be excluded in the computation of this number. The wording of the Section is as follows :—

S. 4. (1) No company, association or partnership consisting of more than ten persons shall be formed for the purpose of carrying on the business of banking unless it is registered as a Company under this Act, or is formed in pursuance of an Act of Parliament or some other Act of the Governor-General in Council, or of Royal Charter or Letters Patent.

(2) No company, association or partnership consisting of more than twenty persons shall be formed for the purpose of carrying on any other business that has for its objects the acquisition of gain by the company, association or partnership, or by the individual members thereof, unless it is registered as a company under this Act, or is formed in pursuance of an Act of Parliament or some other Act of the Governor-General in Council or of Royal Charter or Letters Patent.

(3) *This section shall not apply to a joint family carrying on joint family trade or business and where two or more such joint families form a partnership, in computing the number of persons for the purposes of this section, minor members of such families shall be excluded.*

(4) *Every member of a company, association or partnership carrying on business in contravention of this section shall be personally liable for all liabilities incurred in such business.*

(5) *Any person who is a member of a company, association or partnership formed in contravention of this section shall be punishable with fine not exceeding one thousand rupees.*

It will be seen from the above that this Section does not apply to associations not carrying on any business for gain, such as Literary Associations. It however applies to Mutual Benefit Societies and Loans Societies. The present act further alters the position at law by enacting that every member of a company, association or partnership carrying on business in contravention of this section shall be personally liable for all liabilities incurred in such business. In old law according to decisions these illegal associations could not sue for debts due to them or for breach of contract nor could they be sued (*Ramaswamy* v. *Nagendrayyan*, (1895) 19 *Mad.* 32; *Gujerat Trading Co., Ltd.* v. *Trikumji*, 3 *B. H. Court* 45 *O. C. J.*; *Maneckji* v. *C. N. Cama*, 3 *B. H. Court* 159 *O. C. J.*). Now however though they cannot sue, every member is personally liable for the debts. The Amended Act now provides [S. 4 (5)] that any person who is a member of a company, association or partnership formed in contravention of this section shall be punishable with fine not exceeding one thousand rupees. It has been held that a pool agreement is not a partnership and that even if it were an association it did not fall under S. 4(5) of the Companies Act if the association was formed to stifle competition among owners of ginning factories and was not formed for the purpose of carrying on business within the meaning of S. 4(2) of the Act, as where each of the members was allowed to carry on business in an undisturbed manner and was responsible to the pool whether his constituents paid or not. Simple sharing of profits did not constitute a partnership (*The New Mofussil Co., Ltd.* v. *Rustomji Dhanjishaw Newavala,* (1936) 38 *Bom.*

L. R. 408). A sub-partner is not a member of a firm and does not affect the number of members for the purpose of S. 4 of the Act (*Chandulal Damoderdas* v. *Keshavlal Kubordas Amin,* (1936) 36 *Bom. L. R.* 486).

Companies and Societies

There is no proper decision exactly defining a company and distinguishing same from a Society. The Act S. 2 (2) defines a company to mean one formed and registered under the Indian Companies Act, 1913. Vægham Williams, J. in *Great Northern Railway Co.* v. *Coal Co-operative Society,* (1896) 1 *Ch. D.,* 194 stated that "the word company has come to have a very well-recognised meaning. There are various legal companies but this Industrial Society does not come within the connotation of the word in any of its accepted legal meanings. However the members of an illegal association are individually liable for any orders given or contracts made by them personally. An officer or employee of the Association can be prosecuted for embezzelling the funds of the Society. (*R.* v. *Tankard,* (1894) 1 *Q. B.* 548).

Types of Companies

A company may be formed either as (1) A company limited by shares, *i.e.,* a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them. [S. 5 (1)], or (2) a company limited by guarantee, *i.e.,* a company having the liability of its members limited by its memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up, or (3) a company with unlimited liability, *i.e.,* a company not having any limit on the liability of its members. The last two types of companies may be incorporated or registered with or without share capital.

Statutory Companies

"Statutory Companies" is a name applied to companies which are brought into existence by a Special Act of Parliament or of the Legislative Assembly. Thus we have, as an illustration, the Imperial and Reserve Banks of India which are two of our Statutory Companies, being incorporated under a Special Act of the Legislative Assembly. These Statutory companies are not governed by the Indian Companies Act, 1913, but the Act by which they are formed governs their whole constitution, which Act also frequently embraces Rules and Regulations by which the Corporation is to be controlled as far as internal regulations are concerned and also lays down the method by which the same could be altered.

Public and Private Companies

We shall later see in detail as to how Companies can be formed either as (1) private companies or (2) public companies. In case of private companies, they have to be composed of not less than two members nor more than fifty, not including persons who are in the employ of the company [S. 2 (13)]. Whereas in case of Public Companies, all that the law requires is that there shall be at least seven members, and there is no restriction as to the maximum.

CHAPTER II.

Formation and Incorporation of Companies

General Observations

The promotion of a company is naturally the outcome of a definite scheme. Usually the Secretary is engaged as *pro tem* officer, who conjointly with the Promoters attends various meetings for preliminary discussion and settlement and takes careful notes of various incidents and important items discussed and decided on at these meetings. If the Secretary happens to be a qualified officer, trained in company promotion and practice, his services are bound to prove very valuable in connection with this work, as in that case he would largely guide and advise the promoters on technical questions, thereby saving an amount of expense involved in references to the company's lawyers. It is at these meetings that details as to the preparation of prospectus, memorandum and articles of association, together with clauses, conditions and powers which they should incorporate, are decided upon and finally settled on the footing of which these documents are ultimately drafted. At these preliminary meetings various details as to the selection of the name of the company, whether it has to be a limited company, its capital and how the shares, if any, are to be divided are settled. If preference shares are also to be issued, the nature of the preferential rights have to be laid down, the agreements of vendors as to purchase of property or business by the company if any have to be discussed and settled, the selection of directors will also form part of the discussion and fixing of their remuneration may also be one of the items.

In case of the prospectus there are two branches which call for particular attention of the draftsman. One is concerned with the requirements of S. 93 of the Indian Companies Act 1913 as to what should be the contents of this document, and the other branch relates to business publicity side of this document where facts, figures and arguments have to be incorporated with a view to attract capital. Of course, the Law permits the issue of a prospectus in case of a public company only. A private company cannot make a public offer for the purchase of shares and thus cannot issue a prospectus. The prospectus states the case of the promoters and enumerates the prospects of the company as to success in its operations. We shall deal with details connected with the prospectus later.

In case of the preliminary meetings it is important not only that the *pro tem* secretary should take down careful minutes, but that, the same should be signed by the person who happens to be the chairman of such meetings. The various views expressed and points made should be carefully taken notice of by the Secretary as they might be of consideration value for future reference.

Documents to be filed on Incorporation

The following documents must be filed at the time of incorporation of a company having its share capital divided in shares :—(1) memorandum of association, (2) articles of association. (These need not be filed if the company adopts the Table A), (3) situation of the registered office of the company, (4) a statutory declaration in compliance with the requirements of the Indian Companies Act, 1913, (5) the list of persons who have consented to be directors of the company, (6) consent to act in writing of the directors appointed by the articles. The last requirement does not apply to a private company, or to a company not having a share capital, or to one which was a private company before becoming a public company.

PROMOTERS

A company is generally brought into existence by a person, or a number of persons, who are commonly known as " Promoters."

For the purpose of S. 100, (5) (a) a promoter is defined as one " who was a party to the preparation of the prospectus, or the portion thereof . . . . . . but does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company."

Definition and Work of Promoters

The term " promoters " has been defined by various learned judges in different language, but the gist of all the definitions is to the effect that any individual, syndicate, association or partnership, etc., which puts into motion a machinery by which a company is brought into existence, may be described by that designation. *Bowen, L.J.* defines the promoter as " the term promoter is a term not of law but of business, usefully summing up in a single word a number of business operations, familiar to the commercial world by which a company is generally brought into existence." (*Whaley Bridge Printing Co.* v. *Green,* (1880) 5 *Q. B. D.* 109). On the other hand *Cockburn, C. J.* lays down that he is one who " undertakes to form a company with reference to a given project, and to set it going, and to take the necessary steps to accomplish that purpose " (*Twycross* v. *Grant,* (1877) 2 *C. P. D.* 469 at p. 469 at p. 507). See also *Bagnall* v. *Carlton,* (1877) 6 *Ch. D.* 371; *Emma Silver Mining Co.* v. *Lewis,* (1879) 4 *C. P. D.* 396; *Lydney & Wigpool Co.* v. *Bird,* (1886) 33 *Ch. D.* 85; *Gluckstein* v. *Barnes,* (1900) *A. C.* 240; *Nant-Y-Glo & Blaina Co.* v. *Grave,* (1879) 12 *Ch. D.* 738; *Olympia Ltd.,* (1898 2 *Ch.* 153; *Leeds & Hanley Theatre of Varieties,* (1902) 2 *Ch.* 809). These promoters generally get the original documents, like the memorandum and the articles,

as well as the prospectus prepared, take an active part in the selection of directors, as well as in the purchase of some property by the company for the purpose of carrying on its proposed business, and generally speaking, float or assist in floating, a company, or do any one or more of these operations. *Mr. Palmer* in his Company Precedents divides promoters into three Classes *viz.* :—(1) professional promoters, (2) occasional promoters, and (3) promoters, "pro hac vice." The first are those who make a business or profession of promoting a company, whereas the second do this occasionally as a part of the business. The third, however, are those who do not fall in either of the first two classes named above, but who take part in the promotion of one particular enterprise in which they are directly or indirectly interested, *e.g.*, the inventors of an invention promoting a company to work that invention. All these promoters, no doubt, expect some benefit or profit through this promotion and as long as the remuneration is obtained in good faith, and with due disclosure, it could not be objected to at law. The remuneration may take the form, either of the grant of fully or partly paid shares, or of a lump sum, or the promoter may be the original purchaser of some property which he now arranges to sell to the company at a profit. As the promoter takes a prominent part in bringing the company into existence, he stands in a fiduciary position towards the company, and is thus expected to make a full and fair disclosure of the benefits accruing to him through the promotion. This disclosure is generally made in the prospectus of the company or in its memorandum or articles.

The Legal Position of Promoters

On this point the leading case is that of *Erlanger* v. *The New Sombrers Phosplate Co. and others,* 3 *Ap. Cas.* 1218. Where *Lord Cairne,* expressed himself as follows :—" They stand in my opinion undoubtedly in a fiduciary position. They have in their hands the creation

and moulding of the company; they have the power of defining how, and when, and in what shape, and under what supervision it shall start into existence and begin to act as a trading corporation. If they are doing all this in order that the company may, as soon as it starts into life become, through the managing directors, the purchasers of the property of themselves, the promoters, it is, in my opinion, incumbent upon the promoters to take care that in forming the company they provide it with an executive, that is to say, with a board of directors, who shall both be aware that the property which they are asked to buy is the property of the promoters, and who shall be competent and impartial judges as to whether the purchase ought or ought not to be made. I do not say that the owner of property may not promote or form a joint stock company and then sell his property to it, but I do say that if he does he is bound to take care that he sells it to this company through the medium of a board of directors who can and do exercise an independent and intelligent judgment on the transaction."

The promoters being in a fiduciary position they are accountable to the company just like agents or trustees (*Lydney Co.* v. *Bird,* (1886) 33 *Ch. D.* 85; *Mann* v. *Edinburgh Tramways,* (1893) *A. C.* 69). The promoters' remuneration may be (1) commission from the vendors of the assets or business; (2) profits on the property originally purchased by promoters and then sold to the company; (3) commission on shares sold or for which they procured subscription; (4) a lump sum, or (5) in any other form. Of course these should be fully disclosed in the prospectus as they cannot make secret profits being in a fiduciary position and must get same passed by an independent board of directors (*Gluckstein* v. *Barnes,* (1900) *A. C.* 240) otherwise the company can rescind the contract. (*Leeds Theatre* (1902) 2 *Ch. D.* 809). In case the promoter had acquired the property after he became a promoter, the company has the option either to rescind

the contract or retaining the contract to claim profits for itself (*Bank of London* v. *Tyrrell,* (1862) 10 *H. L. C.* 26).

The cases in which the promoters were compelled to account for and pay back secret profits were, *Emma Silver Mining Co.* v. *Grant,* (1879) 11 *Ch. D.* 918; *Mann* v. *Edinburgh Northern Trams Co.,* (1893) *A. C.* 69; *Gluckstein* v. *Barnes,* (1900) *A. C.* 240; *Bagnall* v. *Carlton,* 6 *Ch. D.* 371. The position in law with regard to the property they sell to the company which belongs to them is that, if the promoter acquired the said property with the original intention of ultimately forming a company and of selling same to it at a profit, the promoter would not be held accountable for the profit he makes on the resale, provided the fact is disclosed that the property which the Company is to acquire is the property of the promoter who is the vendor (*Bentinck* v. *Fenn,* (1887) 12 *A. C.* 652; *Ladywell Mining Co.* v. *Brookes,* (1887) 35 *Ch. D.* 400; *Gover's Case,* (1876) 1 *Ch. D.* 182). The same would be the case if the property acquired prior to the formation and incorporation of the company was not actually transferred to the name of the promoter, but was in form of an auction or uncompleted contract according to *Gover's case* as well as the case of *Ladywell Mining Co.,* cited above. In another case, *viz., Omnium Electric Palaces* v. *Baines,* (1914) 1 *Ch.* 332 where there were only negotiations for a lease which resulted in a lease, the position was declared to be the same. The position however would be different in case the promoter enters into contracts after he began to promote the company, because the benefit of all contracts entered into by him after his position as a promoter was begun or after he began to act as a promoter, would belong to the company according to *Ladywell Mining Company's* case cited above. If the contracts are entered into after the company is incorporated naturally the promoter stands in the position of an agent to the company and cannot make secret profits of which his principal is

not informed (*Morison* v. *Thompson,* (1874) *L. R.* 9 *Q. B. at p.* 484).

To sum up, as the promoter stands in a fiduciary position, he must disclose the fact that he is himself the seller of the property which he has acquired. If he does not, the company would be entitled to rescind the contract and where the property was acquired after he began to work as a promoter, he would be compelled to account for the profits made by himself. He would have also to account for the profits of the company even in cases where he was acting as an agent for the vendors, or for other promoters, because that position would not in any way exonerate him (*Lydney and Wigpool Iron Ore Co., Ltd.* v. *Bird,* (1886) 33 *Ch. D.* 85). Again Section 93(*1*) (*ff*) which has been now added by the Amending Act of 1936 further lays down that while disclosing in the prospectus the names and addresses of vendors of any property purchased or acquired by the company or proposed to be so purchased or acquired, which is to be paid for wholly or partly out of the proceeds of the issue offered for subscription or the purchase or acquisition of which has not been completed at the date of the issue of the prospectus as required by Section 93(*1*) (*f*) and if any property referred to there has within two years preceding the issue of the prospectus been transferred by sale, the amount paid by the purchaser at each such transfer, so far as the information is available, and where any such property is a business, the profits accruing from such business during each of the three years immediately preceding the issue of the prospectus or during each year of the existence of the business, if less than three years, should be disclosed in the prospectus so far as the information is available. The liability to disclose in this connection of the promoter vendor cannot be avoided by putting in a nominee vendor in his place [*Glasier* v. *Rolls,* (1889) 42 *Ch. D.* 442]. Thus here the promoter has to disclose the amount at which the property was purchased by him if that was done within two

years of the issue of prospectus even though this may have been done long before he commenced to act as a promoter. The position would not in any way be improved if he refrains from making disclosures to the company and made it to the board of directors instead who are under his influence or in his pay [*Gluckstein* v. *Barnes,* (1900) *A. C.* 240]. The proper place for such disclosure to be made is the prospectus [*Leeds & Hanley Theatres of Varieties* (1902) 2 *Ch.* 809], but where the issue is not offered to the public and the facts are made known to all the members and the directors that will be suffcient even though the promoter may be making a large profit [*Re. Ambrose Lake Tin Co.,* (1880) 14 *Ch. D.* 390; *Attorney-General for Canada* v. *Standard Trust Co.,* (1911) *A. C.* 498; *Innes & Co.,* (1903) 2 *Ch.* 254; *British Seamless Paper Box Co.,* (1881) 17 *Ch. D.* 467]. In another case where though all the facts were disclosed to the members and the directors, a misleading prospectus was issued to the public inviting subscription, the promoter was held to be liable [*Lagunas Nitrate Co.* v. *Lagunas Syndicate,* (1899) 2 *Ch.* 392 at *p.* 428]. The disclosure of profits made should be a straightforward disclosure and it will not do to state facts which if followed up might ultimately lead to the disclosure of the profits [*Re : Olympia Ltd.* (1898) 2 *Ch.* 153; *Gluckstein* v. *Barnes,* (1900) *A. C.* 240]. Even if there was not an independent board of directors, but the disclosure is made to the shareholders by the Articles and the prospectus or in any other manner, that would be sufficient [*Salomon* v. *Saloman,* (1897) *A. C.* 22; *British Seamless Paper Box Co.,* (1881) 17 *Ch. D.* 467; *Re : Sale Hotel Botanical Gardens,* (1898) 78 *L. T.* 368; *also see Lagunas Nitrate Co., cited above*].

With reference to secret profits which as we have seen, the promoter has to account for, is not disclosed under the circumstances discussed above, the measure of damage is the actual profit made by the promoter, less any reasonable expenditure he may have incurred or paid.

In other words, the measure is based upon net profits made by him [*Leeds & Hanley Theatres of Varieties* (1902) 2 *Ch.* 809; *Emma Silver Mining Co.* v. *Grant*, (1879) 11 *Ch. D.* 918; *Lydney & Wigpool Co.* v. *Bird*, (1886) 33 *Ch. D.* 85]. In case of property acquired or agreed to be purchased by the company, we have seen that if proper disclosures of interest are not made by the promoters, the same would be rescinded. If however circumstances have arisen which make such a rescision impossible, the company would be entitled to obtain damages from the promoter vendor, which damages would be measured on the basis of the difference between the actual price paid by the company and the value which the said property bears on the date the same was purchased [*Leeds Hanley Theatres of Varieties* (1902) 2 *Ch.* 809].

Where the disclosure states a lesser amount of the profits than they actually made, it is as good as no disclosure. In this case the company had gone to a stage where they could not rescind the contract and the Court held that that position would be no bar to relief and ordered the promoters to pay to the company that portion of the profits which were not disclosed [*Gluckstein* v. *Barnes*, (1900) *A. C.* 240]. It may be added here that where there are more than one promoter, these co-promoters are not necessarily the partners or agents of one another, nor necessarily liable for the acts or omission of their co-promoters [*Reynell* v. *Lewis*, (1846) *M. & W.* 517]. Neither death nor bankruptcy of a promoter will release his estates or him from his liability in connection with the breach of fiduciary duties to the company [*Murietta* v. *Concha*, (1889) 40 *Ch. D.* 543 *at p.* 553; *Phillips* v. *Homfray*, (1883) 24 *Ch. D.* 439; *Emma Silver Mining Co.* v. *Grant*, (1881) 17 *Ch. D.* 122].

The following precautions are suggested by Mr. Palmer in his excellent work on Company Precedents, Part I :—

(1) "Where it is intended to purchase property and resell at a profit, either to a company or otherwise, be careful not to take any steps towards the promotion of the company, or

procure directors or subscribers, until you have a valid contract with the vendors; and, having regard to Sections 93 (f) & (g) and 94 of the Indian Companies Act 1913, where practicable, have the contract completed and the purchase money paid before the date of the prospectus."

NOTE :—Under our Amending Act of 1936 even here he shall have to disclose the purchase price of the property he may be selling to the company, if he has acquired same within two years of the issue of the prospectus.

(2) "Remember that grasping at too much profit may easily defeat itself by bringing about the failure of the enterprise."

(3) "See that the company is provided with an independent board of directors, and that due disclosure is made to them and to the Company. Independent here means directors who are not interested in the promotion, *e.g.*, by receiving vendor's shares or being qualified by the promoters."

(4) "See that, where there is or may be any doubt as to the independence of the executive, full disclosure is made of all the variety of matters which *prima facie* ought to be disclosed to an independent executive."

(5) "See that the memorandum and articles contain all requisite provisions for the protection of the promoters (See *Brazilian Rubber Plantations* (*No.* 1), 1911 1 *Ch.* 425) and, at the same time, do not contain anything open to hostile comment, or anything unfair to the company or the subscribers."

(6) "See that the prospectus or statement in lieu thereof, especially if the promoters have any part in its preparation or issue, is fairly and honestly framed."

(7) "Take care in particular that the provisions of Sections 93 and 94 of the Indian Companies Act are complied with."

(8) "Bear in mind Section 105 of the Act, and do not be a party to the payment out of the purchase-money, whether directly or indirectly, of any commission for subscribing or procuring the subscription of shares."

In re : *Brazilian Rubber Plantation and Estates Ltd.*, (1911) 1 *Ch. D.* 425 *as per Neville, J.* "The Company, until in the hands of its own board, is but the creature of the promoters unable to consider its own interest or act on its own behalf." [*See also Emma Silver Mining Co.* v. *Grant,* (1879) 11 *Ch. D.* 918-939; *Omnium Electric P. Ltd.* v. *Baines,* (1914) 1 *Ch. D.* 332].

Acquisition of a Running Business

We have thus seen exactly what is the legal position of promoters. The promoters may be forming the company on the basis of some concessions, or acquisition of some running business with a view to enlarge its scope, or it may be the formation of an entirely new company to start an entirely new business. For acquiring an old business a detailed enquiry has to be made as to the value of assets which are to be taken over, the liabilities and the past profits for which experts have to be engaged who have to go into these questions in detail and report or certify the results of their investigations. The expression "expert" includes engineer, valuer, accountant and any other person whose profession gives authority to a statement made by him [S. 100 (*5*) (*b*)]. These certificates of experts are of considerable value in connection with the statements in the prospectus, because the promoters and directors are responsible for any misstatement, or wrong statement made in the prospectus on their responsibility, whereas if they were to rely upon the report of experts and if the statements made are extracts and quotations from these reports or certificates, they are safe and well fortified. Thus accountants, engineers, architects, etc., will have to be engaged for specific work suitable to their professional ability. The usual practice in such cases is to enter into agreements under which the vendors of these businesses agree to receive in consideration of the sale of the property, certain amount in cash and certain amount in fully or partly paid shares. In some cases, the vendors also agree to pay "underwriting commission", or a part of the preliminary expenditure. The vendors may either join the board of directors or may not. It is frequently necessary, particularly where good-will of the business is also transferred, to see that in their agreement a specific clause is inserted preventing them from carrying on the same type of business within a certain radius and for a specific number of years. It may be that the business carries with it patented inventions, trade marks, secret

processes, registered patterns, etc., in which case the same have to be transferred to the company through this agreement. Frequently a brief proposal embracing all these particulars is prepared in more or less the following form which has to be considered by the promoters in their early meetings in connection with the formation of the company while contemplating the taking over of a going business. The Proposal Form usually embraces the following details :—

PROPOSAL FORM

1. **Suggested Name** :—Framroze Iron Foundry & Iron Works, Ltd.
2. **Situation** :—The business is at present situated in Parel, Bombay, where the firm of Messrs. Framroze and Co., are carrying on business as Iron Founders and Iron Works Owners in their Factory situated there. They own patent rights as well as Trade Marks.
3. **The Approximate Capital Necessary** :—The Company is to be formed with a registered capital of Rs. 20,00,000 of which Rs. 5,00,000 should be made up of Preference Shares of Rs. 1,000 each, and the balance of Rs. 15,00,000, should pe made up of Ordinary Shares of Rs. 500 each.
4. **Consideration to the Vendors** :—The Vendors are to be paid in all Rs. 6,00,000 of which Rs. 3,00,000 is to be paid in cash and the balance of Rs. 3,00,000 is to be paid by allotting Ordinary Shares as fully paid. The Vendors have undertaken to pay all Preliminary Expenses up to allotment. The working capital required by the concern is Rs. 10,00,000, which it is proposed should be acquired from shares issued to the public. The whole of the balance of the share capital should be offered to the public for subscription.
5. **Underwriting** :—The whole of the capital of Rs. 14,00,000 is to be underwritten at a commission of 3%.
6. **The Underwriters** are Messrs. X & Y.
7. **The business is owned** by the present proprietor Mr. J. Framroze of Nepean Sea Road, Bombay.
8. **The list of documents** produced are the following :—
   (*a*) The Balance Sheet and Profit and Loss Account for the past five years duly certified by Auditors Messrs. S. B. & Co.
   (*b*) The inventory of the whole factory, plant and property

machinery as well as building and lands sought to be acquired.

(c) Valuation report of Messrs. Merwanji & Co., Architects and Engineers of Bombay.

9. **General Remarks** :—The proposal is to be considered from the standpoint of the requirements of the manufacturers of the foundry works which are likely to follow due to the building of railway in Rajputana for which the firm is at present negotiating as well as the progressive nature of the business as indicated by the accounts.

Signature :—FRAMROZ & CO.

Bombay, 10*th February*, 1937.

The above form would naturally be signed by the firm offering the business for sale to the company, in this case, Messrs. Framroze & Co. It would first come into the hands of the Secretary, who has to carefully study the details and make his own notes on the points which in his opinion are likely to come up for careful consideration at the promoters' meeting. After these proposals are passed and accepted, assuming that no variation is made in connection with capital and various other proposals in the above proposal form, the next step will be to take the necessary action for the registration or incorporation of the company concerned.

Agreements with Promoters and Vendors

It may be added that the promoters may be proprietors of the old established concern itself or outsiders. In case of the outside promoters, promoting either an old established business, or an entirely new company, it is the usual thing for them to be remunerated for their labour, skill and ingenuity in connection with the formation of the company. This remuneration may be in form of cash or partly in cash and partly in shares or wholly in either. The remuneration which the promoters take should be fully disclosed in the prospectus and that under no circumstances any secret profit at the expense of the company they promote is permissible, because in case they were to make such profits the company may compel the

promoters concerned to surrender the same to it [*Mann & Beattle* v. *Edinburgh Northern Tram Co.*, (1893) *A. C.* 69; *Gluckstein* v. *Barnes,* (1900) *A. C.* 240]. This rule of course applies only to secret profits, as for profits disclosed there could be of course no objection [*Lydney and Wigpool Iron Ore Co.* v. *Bird,* (1886) 33 *Ch. D.* 85; *Re* : *Jubilee Cotton Mills,* (1923) 1 *Ch. D.* 1924 *A. C.* 958].

The agreements that may have to be drawn up are :—

(1) Agreement between promoters laying down their respective rights and obligations.

(2) Agreements between promoters on the one part and the vendors on the other part, in which the usual provisions are that the promoters are to float the company within certain period according to a certain scheme and the vendors are to transfer certain assets at a certain price payable in the manner agreed upon. Usually the preliminary expenses are payable by the promoters or the vendors, if so that has to be mentioned. All these agreements must embrace a clause declaring that in the event of the company not being entitled to commence business owing to the failure of the floatation, through not securing of the minimum subscription, or any other cause, the agreements are to be considered as rescinded.

(3) There also should be a draft agreement between the promoters or vendors on one part and the company on the other part, in case the business is to be taken over on the incorporation of a company. This draft agreement is usually referred to in the memorandum of association in the "objects clause" and is also stated in the articles of association.

The practice however is to refer the contracts "as contracts for acquisition of business of Messrs. X. Y. Z. in accordance with a draft which has been prepared and

initialled for identification by Mr. J., the Lawyer of the company."

NOTE :—See Special Articles re. Preliminary Agreements given later.

(4) It may be added that in India a large number of companies are promoted by firms or companies of managing agents who in consideration of the trouble and work of promotion usually reserve to themselves in their managing agency agreements remuneration as well as rights and privileges of management, etc. In such cases managing agency contracts must also be drawn up in proper form and stated in the memorandum and the articles of association.

As we shall see later in detail the agreements with vendors have to be disclosed in the prospectus and where there are more than one vendor, the amount so payable to each vendor has to be separately stated. In the latter case, where the vendors are a firm, the members of the firm shall not be treated as separate vendors. [S. 93 (*f*) (*ff*)].

Who is a Vendor ?

In connection with this it is necessary to note the exact definition as to the meaning of the term "vendor" as given in S. 94.

"For the purposes of section 93 every person shall be deemed to be a vendor who has entered into any contract, absolute or conditional, for the sale or purchase, or for any option of purchase, of any property to be acquired by the company, in any case where—

(*a*) the purchase-money is not fully paid at the date of issue of the prospectus; or

(*b*) the purchase-money is to be paid or satisfied wholly or in part out of the proceeds of the issue offered for subscription by the prospectus; or

(*c*) the contract depends for its validity or fulfilment on the result of that issue.

Promoter Companies

Frequently one company promotes another under the Indian Companies Act of 1913. There are occasions when a special promoting company with limited liability is formed by a syndicate with the specific object of forming some particular company. Here the promoters arrange to hold shares in the promoting company, but as soon as the company they projected to promote is floated, the promoting company is wound up and the net proceeds are distributed among the shareholders, *i.e.*, the members of the syndicate. This course is adopted with the two-fold object of concealing the identity of the promoters, and at the same time of protecting themselves against personal liability and other dangers. This object is effectively achieved as far as the civil liability is concerned, because shareholders of this promoting company are not personally liable for contracts made by the promoting company which as we have noticed is a limited company, but where this promoting company commits a breach of duty or fraud, the directors of such company are liable personally. On the same footing the directors of this promoting company will be liable for not disclosing profits made by the promoting company in the prospectus because that course is tantamount to a breach of trust or fraud. (*Emma Mining Co.* v. *Grant,* (1881) 17 *Ch. D.* 122; *Barnes* v. *Addy,* 9 *Ch. D.* 244). If, however, this syndicate of promoting company formed to promote had made illicit profits from the company so promoted they could be followed even in the hands of members of the promoting company.

PRELIMINARY CONTRACTS

A joint stock company is on the same footing as a private individual as to the contracts made by it, provided the said contracts are within its constitutional powers. Being an inanimate person created by law, it naturally

contracts through its agents who are its directors and officers duly authorised to sign on its behalf.

In this connection S. 88 is important which lays down as follows :—

(1) Contracts on behalf of a company may be made as follows (that is to say) :—

(*i*) any contract which, if made between private persons, would be by law required to be in writing, signed by the parties to be charged therewith, may be made on behalf of the company in writing signed by any person acting under its authority express or implied, and may in the same manner be varied or discharged;

(*ii*) any contract which, if made between private persons, would by law be valid although made by parol only, and not reduced into writing, may be made by parol on behalf of the company by any person acting under its authority, express or implied, and may in the same manner be varied or discharged.

(2) All contracts made according to this section shall be effectual in law, and shall bind the company and its successors and all other parties thereto, their heirs, or legal representatives, as the case may be.

Agreements Prior to and After Incorporation

In case of joint stock companies, the promoters frequently enter into contracts before incorporation. It has been held that such contracts are not binding on the company, nor can the company adopt or ratify same, because no one can act as an agent or a trustee for a party which did not exist at the time when the contract was made (*Imperial Ice Co.* v. *Manchershaw,* (1889) 13 *Bom.* 415; *Kelner* v. *Baxter,* (1867) *L. R.* 2 *C. P.* 174). It is usual to make the adoption of a preliminary agreement one of the objects of the company in the memorandum and also to provide for same being done in the articles of association. However, this course also does not bind the company to adopt this preliminary agreement, unless a distinctly new contract is made by which the company agrees to be bound by the terms of the preliminary

agreement [*Natal Land Company* v. *Pauline Colliery*. (1904) *A. C.* 120; *Re* : *Olympia Ltd.*, (1898) 2 *Ch.* 153].

There are occasions, however, where the promoters purchase property with a view to resell same at a profit to a company which they have the intention to float thereafter. In this case, if the promoters take the precaution to complete the purchase agreement before the floatation of the company, which they have in contemplation, and then float the company fully disclosing the profits they are going to make before an independent board of directors, as well as to the company, there would be no difficulty. This point has been fully dealt with along with relative authorities under the heading of the "Legal Position of Promoters." The directors are said to be independent when they are not interested in the profits of the promotion in any way.

Specimen Clauses re. Preliminary Agreements

A sub-clause which is generally added in the objects clause in the memorandum of association in case of preliminary agreements where a company is formed to acquire an existing business usually runs as follows :—

> "To start, acquire, print, publish, and circulate or otherwise deal with any Newspaper or Newspapers or other publications, and generally to carry on the business of Newspaper Proprietors and General Publishers and Printers, and in particular to acquire from the Liquidator of "X. Y. Z., Limited" the entire stock-in-trade, plant, outstandings and goodwill of the business of the said "X. Y. Z., Ltd.," and to work the business of newspaper proprietors and general publishers and printers and of the daily and weekly newspaper called "The Thunder" under the same or any other name."

In the articles of association also preliminary contracts are generally referred to as follows :—

"The Company shall enter into the following Agreements :—

(*a*) An Agreement with Messrs. A. B. & Co., on the terms set forth in the draft of such agreement, and which agreement will provide for the acquisition by the

Company of mining and other rights granted to or secured by Messrs. A. B. & Co. from the Government of India.

(b) An agreement with Messrs. A. B. & Co., on the terms set forth in the draft of such agreement, and which agreement will provide for Messrs. A. B. & Co. and their successors acting as managing agents of the company.

(c) An agreement with Mr. S. and others, on the terms set forth in the draft of such agreement, and which agreement will provide for the allotment to the said Mr. S. and others as fully paid up of 1,330 ordinary shares of Rupees 75 each as remuneration for services rendered in and about the formation and promotion of the company."

It may be added that in case of Indian company promotion this form has now become almost universal. Here a draft agreement is prepared before incorporation of the company which is referred to in a memorandum and articles of association as an agreement already drawn up and intended to be executed. For identification the said agreement or contracts are initialled by one or more of the subscribers or would-be directors. The agreement then comes up before the board meeting of the directors after the company is registered and is entitled to commence business where it must be adopted, signed and sealed by the directors after due consideration. In this case the board should be a board of independent directors as we have already stated above.

For Forms & Precedents of Preliminary Agreements

See Vol. II, Appendix A and Index.

UNDERWRITING AGREEMENTS

With regard to underwriting agreements under which some person or persons, or a syndicate, enters into an agreement called underwriting agreement by which they undertake in consideration of a certain commission being paid to them on the capital offered for public sub-

scription, to take up and pay for such of the shares as are not taken up by the public, it may be said that these agreements are made in order to ensure the financial safety of the floatation of the company, *i.e.*, to make sure that the capital necessary to carry on the business of the company is obtained. With regard to the underwriting agreements, the leading case is *Re* : *Licensed Victualler's Mutual Trading Association* (1889) 42 *Ch. D.* 1. Here in the opinion of Cotton, L.J., an underwriting agreement is " an agreement entered into before the shares are brought before the public, that in the event of the public not taking up the whole or the number mentioned in the agreement, the underwriter will, for an agreed commission, take the allotment for such part of the shares as the public has not applied for." In the same case Lindley, L.J., also expressed himself thus :—" Underwriting, in this connection in business means agreeing to take so many shares more or less in number as are specified in the underwriting letter if the public do not subscribe for them. There is no doubt now that this is the meaning of underwriting."

This old aspect of law has been altered by subsequent enactment which now permits underwriting commission being paid to all who " subscribe for shares " and that too " whether absolutely or conditionally." Thus it is not now compulsory that there shall be a public offer in the first instance as laid down or assumed in the above decision, because, according to Sec. 105 of the Indian Companies Act :—

S. 105. (1) It shall be lawful for a company to pay a commission to any person in consideration of his subscribing or agreeing to subscribe whether absolutely or conditionally, for any shares in the company, or procuring or agreeing to procure subscriptions, whether absolute or conditional, for any shares in the company, if the payment of the commission is authorised by the articles, and the commission paid or agreed to be paid does not exceed the amount or rate so authorised and if the amount or rate per cent of the commission paid or agreed to be paid is :—

(*a*) in the case of shares offered to the public for subscription, disclosed in the prospectus; or

(*b*) in the case of shares not offered to the public for subscription, disclosed in the statement in lieu of prospectus, or in a statement in the prescribed form signed in like manner as a statement in lieu of prospectus and filed with the Registrar and where a circular or notice not being a prospectus inviting subscription for the shares is issued, also disclosed in that circular or notice.

(2) Save as aforesaid, and save as provided in section 105A no company shall apply any of its shares or capital money either directly or indirectly in payment of any commission, discount or allowance to any person in consideration of his subscribing or agreeing to subscribe whether absolutely or conditionally, for any shares of the company, or procuring or agreeing to procure subscriptions, whether absolute or conditional for any shares in the company, whether the share or money be so applied by being added to the purchase money of any property acquired by the company or to the contract price of any work to be executed for the company, or the money be paid out of the nominal purchase money or contract price or otherwise.

(3) Nothing in this section shall affect the power of any company to pay such brokerage as it has heretofore been lawful for a company to pay, and a vendor to, promoter of, or other person who receives payment in money or shares from, a company shall have and shall be deemed always to have had, power to apply any part of the money or shares so received in payment of any commission, the payment of which if made directly by the company, would have been legal under this section.

Section 106 further lays down that where the company has paid such commission in respect of any shares or debentures or allowed any sums by way of discounts in respect of any debentures, the total amount so paid or allowed, or so much thereof as has not been written off, shall be stated in every balance sheet of the company until the whole amount thereof has been written off. Thus it will be seen that the commission must be autho-

rised by the articles and the rate agreed to be paid must not exceed that fixed by the articles, and that the said commission is disclosed in the prospectus in case where the shares are offered to the public. Where the articles lay down a percentage of commission to be paid a commission made up of a lump sum will not satisfy the claim (*Booth* v. *New Afrikander Gold Mining Co.,* (1903) 1 *Ch.* 295). Where a commission is to be paid for subscribing shares and before it is paid winding up supervenes, though the shareholder will have to pay all his calls unpaid in full he shall rank as an unsecured creditor with respect to his claim for the underwriting commission (*Keatinge* v. *Paringa Consolidated Mines,* (1902) *W. N.* 15). Where there is no prospectus issued to the public, the amount or rate of the underwriting commission must be disclosed in the statement in lieu of prospectus. Where any issue of shares or debentures is underwritten, the names of the underwriters, and the opinion of the directors that resources of the underwriters are sufficient to discharge the underwriting obligations should be stated. [S. 93 (*1*) (*ee*)]. It has been held that commission cannot be paid out of a premium payable to the company on the issue of shares (*Shorto* v. *Colwill,* (1909) 101 *L. T.* 598). Of course, the payment of the usual and reasonable brokerage or commission to brokers, bankers and the like is not prohibited by this Section 105 (*Andreae* v. *Zinc Mines of Great Britain,* (1918) 2 *K. B.* 454). An option to underwriters to subscribe for further shares as consideration for underwriting is not an application of shares in payment of commission (*Hilder* v. *Dexter,* (1902) *A. C.* 474).

UNDERWRITING COMMISSION

With regard to underwriting the following points should be noted :—

(1) Where there is public issue.

(*a*) The articles of association, either as originally framed or altered by special

resolution, must authorise payment of the commission.

(*b*) In case of shares offered to the public for subscription the commission must be disclosed in the prospectus.

(*c*) The commission paid or agreed to be paid should not exceed the amount, or rate, authorized to be paid.

(II) Where there is no public issue.

(*a*) In case of shares not offered to the public the commission must be disclosed in the statement in lieu of prospectus.

(*b*) The commission to be paid or agreed to be paid should not exceed the amount, or rate authorized.

It has been held that on a reconstruction the old company may pay a commission for undertaking to purchase shares which are partly paid from the liquidator of the old company and thereby becoming liable to pay up the balance on the shares (*Barrow* v. *Paringa Mines, Ltd.*, (1909) 2 *Ch.* 658). Of course this does not prevent the company from paying the usual brokerage to brokers, bankers, etc. (*Andreae* v. *Zinc Mines of Great Britain*, (1918) 2 *K. B.* 454).

As we shall see later underwriting agreements are nowadays prepared in proper forms as given in Appendix A (See Index Vol. 2). Where they are reduced to a form of an offer and an acceptance the underwriter was supposed to give that offer; but now, as given later, the underwriter is made to accept the offer which the company is supposed to have given, so that, the chance of the underwriter backing out of the contract by a revocation is avoided in the underwriting letters. These underwriting letters must be stamped as an agreement. It may be added that though it is most desirable as is usual in practice to have an underwriting agreement reduced

to writing, in strict law that is not compulsory. Thus an acceptance of such an agreement may be written or oral (*North Charterland Exploration Co.* v. *Riordan,* (1896) 13 *T. L. R.* 80). In case the underwriting agreement lays down that "I will if called upon by you subscribe, etc." the authority does not arise until after the condition is performed (*Ormerod's Case,* (1894) 2 *Ch.* 474; *Brussels Palace of Varieties* v. *Prockter,* (1893) 10 *T. L. R.* 72). An agreement to take shares must be distinguished from an agreement to take shares. (*Gorrissen's Case,* (1873) *L. R.* 8 *Ch. Ap.* 507).

Forms of Underwriting Agreements

See Appendix A and Index Vol. II.

Summary of Main Points

To summarise, the main points which an underwriting agreement should contain are :—

(1) That the agreement should be so drafted as to be a final and binding agreement and not one which is likely to give the underwriter any loophole to escape either on the ground that the draft of the prospectus was altered subsequently without his permission, or that he only gave an offer to underwrite which was not accepted, or that he was only bound to pay if called upon;

(2) the prospectus should contain a specific undertaking to underwrite a certain number of shares and that the whole of those shares are to be offered to the public;

(3) that the underwriter has agreed to take up and pay for such shares as are not taken up by the public;

(4) that the underwriter specifically authorises the company to allot the balance of shares to him or his nominees which are not taken up by the public;

(5) that the company in return agrees to pay specific commission of so much per share or so much per cent. on all the shares underwritten whether the underwriter has to take them up or not.

In case of underwriting letters, in order to avoid their being drafted in form of an offer which the underwriter would be entitled to withdraw before the company accepts same, Mr. Palmer suggests that the form should be as :—

"I accept your offer to allow me to underwrite............ Shares on the terms following, etc.

The point to be noted is that where the underwriter's offer is addressed to the company, or to the agent of the company and is duly accepted and the offer is to underwrite certain shares the underwriter can, without any further application for shares by him, be put on the register of members. (*Ex Parte*) *Audain*, (1889) 42 *Ch. D.* 1). The agreement to underwrite a portion of the shares which was of the nominal value of £1 each in the *Licensed Victuallers' Mutual Trading Associations, Ltd.*, (1889) 60 *L. T.* 684 was embodied in two letters dated the 19th of March, 1889, in the following forms :—

"Gentlemen,—In consideration of your underwriting £10,000 'A' Shares in the Licensed Victuallers' Mutual Trading Association, Limited, at 15 per cent. discount, I, acting on behalf of the company, undertake that all applications which have been received up to the present time, or may be received within one week of the closing of the lists, shall be allotted in full from the said 10,000 shares underwritten by you.

Yours truly,
GEO. RUDALL."

The second letter was written to George Rudall by Audain, and was as follows :—

"Dear Sir,—Referring to your favour of even date, copy of which we enclose, we hereby agree to underwrite £10,000 'A'

Shares in the Licensed Victuallers' Mutual Trading Association, Limited, on the terms named therein.

Yours faithfully,
HOLLOWAY & CO."

"P. S.—We further agree to pay the application money upon any balance of shares required to make up the 10,000 within one week's date.

HOLLOWAY & CO."

It was held after the Court had heard expert evidence as to the term "under-writing" as applied to shares issued by a company which had been formed and before its shares had been fully offered to the public, that "the agreement as embodied to underwrite must be treated not merely as a guarantee, but as an application for an allotment of so many of the 10,000 shares as should not be applied for by the public, and that such agreement authorises the secretary to issue an allotment to H. & Co." If on the other hand the underwriters' offer was made to the promoter, as distinguished from the offer made to the company, the underwriter cannot be put on the register unless he makes further application for shares, or in hi offer itself he has authorised the promoter to apply in his name (*Holophane Limited* v. *Hesselphine,* (1896) 41 *Sol. J.* 28). Usually the rule is that irrespective of the fact whether the underwriter may have signed the agr ment before or after the underwriting letter was signed, he can obtain relief on the ground of misrepresentation if he with the knowledge of the promoters relied on the draft prospectus in which these misrepresentations were made. Even when the underwriting letter contains the provision that the agreement was to hold good in spite of variations in the prospectus, the underwriter is not bound if the variations or changes virtually constitute a different venture. (*Warner International Co.* v. *Kilburn,* (1914) *W. N.* 61). In one case it was held that the retention of the underwriting letter by the promoter to which the underwriter consented raised an inference that the bargain

was complete (*Ex Parte Cox Hughes,* (1897) 75 *L. T.* 669). The underwriting agreements can be enforced even against the executors of the deceased underwriter, because it has been held that the duty imposed of finding capital is not such a personal contract as would come to an end with the contractor (*Warner Engineering Co.* v. *Brennan.* (1914) 30 *T. L. R.* 191; *Re* : *Worthington Ex Parte Pathe Freres,* (1914) 2 *K. B.* 299).

Underwriting of Debentures

The law as to the underwriting of debentures is now brought on the same footing as the underwriting of shares, and by Section 128 of the Indian Companies Act, 1913, it is now clearly laid down that a contract with a company to take up and pay for any debentures of the company may be enforced by a decree for specific performance. In case of the underwriting of debentures it is not necessary to state the commission to be paid in the statement in lieu of prospectus where the prospectus has not been issued (S. 93 (1) h). However where a prospectus is issued, the commission must, of course, be disclosed. The other place where the commission is required to be disclosed is the Annual Summary (S. 32 (2) f). It has been also held that where there is an agreement to pay a commission to a lender for procuring an advance to the company, and ultimately, instead of debentures, arrangement is made that the lender should be given shares, the commission will not be recoverable unless disclosed in the statement in lieu of prospectus (*Andreae* v *Zinc Mines Ltd.,* (1918) 2 *K. B.* 454).

Shares at a Discount

The Indian Companies Amendment Act of 1936, Section 105 A introduces an innovation as far as the Indian Companies Act is concerned, in as much as that section adopts section 47 of the English Companies Act of 1929 permitting companies to issue shares at a discount. This innovation was recommended in England by the Green

Committee report of 1925-26 on the ground that there was an overwhelming body of commercial opinion in favour of giving companies this power and the Committee itself thought that in many cases such a power would be extremely useful.

According to Mr. L. Cuthbert Cropper, F.C.A., Chartered Accountant, in his book on Higher Book-keeping and Accounts (5th edition), page 352, "the powers thus given by the Act may be useful where a company requires further capital at a time when its shares are quoted below par, since the existing members or new subscribers naturally would not be willing to pay for new shares under such circumstances, but might be willing to subscribe at the market price, or at a price slightly below market price."

Though of course according to old decisions the issue of shares at a discount in England also was declared to be illegal, in actual practice this issue of shares at a discount in some measure was indirectly done even under the old Act under the guise of paying an under-writing commission to those who agreed to subscribe for the shares. It is now lawful for a company to issue at a discount shares of a class already issued provided (*a*) the issue at a discount is authorised by a resolution passed in a general meeting of the company and sanctioned by the Court, (*b*) the resolution must specify the maximum rate of discount (not exceeding ten per cent. in any case) at which the shares are to be issued, (*c*) not less than one year must at the date of issue have elapsed since the date on which the company was entitled to commence business and (*d*) the shares to be issued at a discount must be issued within six months after the date on which the issue is sanctioned by the Court or within such extended time as the Court may allow.

The further condition imposed is that every prospectus relating to the issue of shares and every balance sheet issued by the company subsequently through the issue of the shares, must contain particulars of the

discount allowed on the issue of the shares or of so much of the discount as has not been written off on the date of the issue of the document in question. The penalty imposed in default in connection with the complying with section 105 A (*ii*), *i.e.*, with regard to the prospectus as stated above, is a fine not exceeding Rs. 50 [Section 105 A (*iii*)].

It may be however added that the issue of shares at a discount would be legal only in case where the same complies strictly with all the requirements of Section 105 A In case any contract is made to issue shares at a discount which does not fall under the provisions of Section 105 A, the party cannot be compelled to accept the shares at the full value payable in cash, but the purchasing shareholder can be forced only to pay that amount which according to contract he had actually agreed to pay, the balance being only recoverable if and when liquidation supervenes (*Re: Macdonald, Sons & Co.*, (1894) 1 *Ch.* 89; *Pioneers of Mashonaland Syndicate* (1893) 1 *Ch.* 731).

It was further laid down in *Macdonald's case* quoted above that in case the members object to be entered on the register on the ground that they agree to take up fully or partly paid shares, which shares the company was not in a position to allot, the company cannot place them on the register.

DOCUMENTS TO BE FILED FOR INCORPORATION

The Memorandum and Articles of Association will be dealt with in a separate Chapter. We shall therefore now take up the other documents and their forms.

The Statement of the Nominal Capital of the Company

This is a simple statement showing the amount of authorised capital of the company prepared for the

purpose of the affixing of the stamps for capital duty on the entire nominal capital of the company as stated in the Memorandum.

Consent to Act as Directors

This is a very important statement because section 84 lays down that a person shall not be capable of being appointed a director of a company by the articles, and shall not be named as a director or proposed director of a company in any prospectus issued by or on behalf of the company or in relation to any intended company or in any statement in lieu of prospectus filed by or on behalf of a company, unless, before the registration of the articles or the publication of the prospectus, or the filing of the statement in lieu of prospectus, as the case may be, he has by himself or by his agent authorised in writing :—

(*i*) signed and filed with the registrar a consent in writing to act as such director; and

(*ii*) save in the case of companies not having a share capital, either signed the memorandum for a number of shares not less than his qualification (if any), *or taken from the company and paid or agreed to pay for his qualification shares,* or signed and filed with the registrar a contract in writing to take from the company and pay for his qualification shares (if any) *or made and fled with the registrar an affidavit to the effect that a number of shares not less than his qualification (if any) are registered in his name.*

The words in italics have been added by the Amending Act of 1936. This section does not apply to a private company nor to a prospectus issued by or on behalf of a company after the expiration of one year from the date at which the company is entitled to commence business.

The statement will have to be prepared in the following form :—

FORM OF
CONSENT OF DIRECTOR TO ACT.
The Indian Companies Act, 1913.
(Section 84).

Filing Fee Rs. 3.

Consent to act as Director of the to be signed and filed pursuant to Section 84(1) (*i*).

Presented for filing by

To the Registrar of Joint Stock Companies—

(*a*) , the undersigned, hereby testify

(*b*) consent to act as Director of the pursuant to Section 84(1) (*i*) of the Indian Companies Act, 1913.

*NAME	ADDRESS.	DESCRIPTION.

Dated this..............of..........19

Section 84 (3) of the Indian Companies Act provides that :—

"This section shall not apply to a private company †*or a company which was a private company before becoming a public company* nor to a prospectus issued by or on behalf of a company after the expiration of one year from the date at which the company is entitled to commence business."

List of Persons Consenting to Act as Directors

Besides the above consent to act as directors given under the signature of the directors themselves, the

* If a Director signs by his agent authorised in writing the authority must be produced and a copy filed.

† Added by the Amending Act of 1936.

secretary or managing director, or director of the company has to file with the registrar of joint stock companies a list of persons who have consented to be directors, and if this list contains the name of any person who has not so consented, the applicant shall be liable to a fine not exceeding Rs. 500. This requirement also does not apply to a private company. This list is to be prepared in the following form as provided for by the Act :—

FORM OF
LIST OF PERSONS CONSENTING TO BE DIRECTORS

The Indian Companies Act, 1913.
(See Section 84).

Filing Fee Rs. 3.

List of the persons who have consented to be directors of the........................to be filed with the registrar pursuant to section 84(2).

Presented for filing by...............

To the registrar of joint stock companies—

(*a*)....................., the undersigned, hereby give you notice, pursuant to section 84(2) of the Indian Companies Act, 1913, that the following persons have consented to be directors of the

Signature, address and description
of applicant for registration.

Signature.......................
Secretary.

NAMES.	ADDRESSES.	DESCRIPTION.

Dated this...........day of...............19....

Statutory Declaration of Compliance

The other document to be submitted for filing to the registrar is a declaration by an advocate, attorney or pleader entitled to appear before a High Court who is engaged in the formation of the company or a person named in the articles as a director, manager or secretary of the company, for complying with all or any part of the requirements of the Companies Act. This declaration has to be made in the following form :—

FORM OF
DECLARATION ON REGISTRATION OF COMPANY.

The Indian Companies Act.
(See Section 24).

Filing Fee Rs. 3.

Declaration of compliance with the requirements of the Indian Companies Act, 1913, made pursuant to section 24(2) on behalf of a company proposed to be registered as the.............

Presented for filing by.......................I.............
..........of....................do solemnly and sincerely declare that I am........(*a*) of the ....and that all the requirements of the Indian Companies Act, 1913, in respect of the matters precedent to the registration of the said company and incidental thereto have been complied with, save only the payment of the fee, and sums payable on registration. And I make this solemn declaration conscientiously believing the same to be true.

(*a*) Here insert—"an advocate, attorney or pleader entitled to appear before a High Court who is engaged in the formation of the company" or a person named in the articles as a director, manager or secretary of the company.

Notice as to Situation

The Companies Act S. 72 lays down that a company either from the date on which it begins to carry on business or as from the twenty-eighth day after date of its incorporation, whichever, is the earlier, must have a registered office at which all communications and notices may be addressed. The notice of the situation of the

registered office and of any change therein must be given within twenty-eight days after the date of the incorporation the company or of the change, as the case may be, to the registrar who shall record the same. It is further added that the inclusion in the annual return of a company of the statement as to the address of its registered office shall not be taken to satisfy the obligation imposed by this section. The section also imposes a fine not exceeding Rs. 50 for every day for which it carries on business without complying with the requirements of this section. This section has been substituted by the Amending Act of 1936 for the old S. 72. The form of the notice of situation of the registered office will be on the following form :—

The Indian Companies Act, 1913.
Section 72.

NOTICE OF THE
SITUATION OF THE REGISTERED OFFICE
OF

....Ltd.

To,

The Registrar of Joint Stock Companies,
Bombay.

The directors of the above-named company hereby give you notice pursuant to Section 72(1) of the Indian Companies Act, 1913 that the registered office of the company is situated at......
....

Signature....................

Dated,...................... *Secretary.*

Registration and Filing Fees

Various fees have to be paid under Section 249 to the registrar of joint stock companies with regard to several matters mentioned in Table B in the First Schedule of the Act. There are smaller fees payable in

connection with this as the Governor-General in Council may direct. For detailed reference as to this table of fees, the Appendix Vol. II where the same are given may be referred to. The stamps required on the documents *viz* : the memorandum of association and the articles are also given there.

Certificate of Incorporation

When the proper documents are thus filed with the registrar of joint stock companies and the requisite fee duly paid, the registrar issues a certificate known as the "Certificate of Incorporation." This certificate, according to section 24, shall be conclusive evidence that all the requirements of the Indian Companies Act, 1913 in respect of registration and all matters precedent and incidental thereto have been complied with and that the association, as a company, is authorised to be registered and duly registered under this Act. The certificate of the registrar is conclusive that the terms of the memorandum are within the law and thus the only thing that the Court can do is to construe the memorandum as it stands (*Cotman* v. *Brougham,* (1918) *A. C.* 514). On the question of conclusiveness of the certificate of incorporation see Lord Cairn's judgment at page 682 in *Peel's Case,* (1867) 2 *Ch. Ap.* 674. The certificate is conclusive also that the company came into existence of the date of the certificate and was in existence for the whole of the said day (*Jubilee Cotton Mills* v. *Lewis,* (1924) *A. C.* 958). Mr. Palmer, in "Palmer's Company Precedents" states as follows :—"Looking to the decisions and to the Section, it is clear that there is no further room for questioning even if the seven signatures to a memorandum were all written by one person, or were all forged, the certificate would be conclusive evidence that the company was duly incorporated." This is so even when the conditions of registration were not duly complied with (*Moosa Goolam Ariff* v. *Ebrahim Goolam Ariff,* (1913) 40 *Cal.* 1; (1912) 14 *Bom.* L. R. 1211). So, too if the signatories were all

infants, the certificates would be conclusive, whether the remarkable decision in *Laxon & Co.*, (1892) 3 *Ch.* 555 that an infant is a "person" within Section 6, can or cannot be supported."

It may be added that the Act contains no provisions for giving the Court power to annul a certificate of incorporation and disincorporate a company which has already been registered. It may be however noted that in *Bowman* v. *Secular Society, Limited,* (1917) *A. C.* 406 Lord Parker of Waddington, in the course of his judgment stated that in case where the company was improperly registered, the Attorney-General on behalf of the crown could institute proceedings by way of *certiorari* to cancel a registration with the registrar. The actual wording of his Lordship was :—

> "Only by misconduct or great carelessness on the part of the Registrar could a company with objects wholly illegal obtain registration. If such a case did occur it would be open to the Court to stay its hand until an opportunity had been given for taking the appropriate steps for the cancellation of the certificate of registration. It should be observed that the Companies Act is not so express as to bind the Crown, and the Attorney-General, on behalf of the Crown, could institute proceedings by way of *certiorari* to cancel a registration which the Registrar in discharge of his quasi-judicial duties had improperly allowed."

Thus His Lordship thought that the Attorney-General on behalf of the Crown could take action in such a case.

Striking off or Restoration of Companies

The registrar of joint stock companies has under Section 247 power to strike off from the register different companies where he has reasonable cause to believe that they are not carrying on business or in operation. The procedure is that in the first instance a letter is sent by ordinary post enquiring whether the company is carrying on business, or is in operation and failing to receive a reply within one month, the registrar has to send a further letter by registered post in which reference is to

be made to the first letter, to which also when no reply is received within one month from the date thereof, a notice is to be published in the local Official Gazette with a view to striking the name of the company off the register. If at the expiration of the time mentioned in the notice, no cause to the contrary is shown, the name is struck off the register. This is of course subject to the right of a member, or creditor of the company to get the company's name restored on the register. The Court would restore the company if satisfied that it was at the time of striking off carrying on business or was in operation, or otherwise that it is just that the company be restored to the register or that the name should be restored. In case of such restoration the company shall be deemed to have continued in existence as if its name had not been struck off. A further power is given to the Court to give such directions, or make such provisions as seem just, for placing the company and all other persons in the same position as nearly as may be as if the name of the company had not been struck off. A letter or notice to be given under this section 247 must be addressed to the company at its registered office, or if no office has been registered to the care of some director, manager or other officer of the company. In case there is no director, manager or other officer of the company whose name and address are known to the registrar, it may be sent to each of the persons who subscribed the memorandum addressed to him at the address mentioned in the memorandum. Even after the date of the dissolution, application to reinstate the name of the company on the register may be made by a member or creditor. (*Hall (Conrad) & Co., Ltd. Re:* (1916) 60 *Sol. J.* 666). It may be remembered, however, that a company which is in course of being wound up "voluntarily" is in operation within the meaning of this Section. (*Outlay Assurance Society,* (1887) 34 *Ch. D.* 479; *re Langlaagte Proprietary Co.,* (1912) 28 *T. L. R.* 529).

FORM OF
CERTIFICATE OF INCORPORATION.

No............19..............

I hereby certify that....................................Ltd.
....is this day incorporated under the Indian Companies Act, 1913, and that the company is limited.

Given under by hand at..
this....................day of..................19......

Signature..................
Registrar of Joint Stock Companies.

CHAPTER III.

The Prospectus

General Remarks

The idea of the prospectus, no doubt, primarily happens to be to invite applications for shares of the company offered to the public and thereby obtain the necessary capital.

The prospectus is defined by Section 2 (14) as "any prospectus, notice, circular, advertisement, or other invitation offering to the public for subscription or purchase any shares or debentures of a company, *but shall not include any trade advertisement which shows on the face of it that a formal prospectus has been prepared and filed.*" (The words in italics have been added by the Amending Act of 1936). This amendment now makes the decision in the case of *Prama Nath Sanyal* v. *Kali Kumar Dutta,* (1925) 52 *Cal.* 440 obsolete. This amendment was influenced by the argument that advertising of a full and complete prospectus in various newspapers was too expensive a burden on smaller companies. It will thus be seen that the definition of prospectus is all embracing. As we have seen above the essence of the prospectus is that there shall be an invitation to the public to subscribe the shares of the company and where a document does not incorporate such an invitation to subscribe shares, it does not fall within the definition of a prospectus. The other point is that the invitation should be to the public, and therefore a letter addressed to a particular individual privately inviting him to buy certain shares in a new company is not necessarily a prospectus.

This prospectus is generally prepared under the direction of those who have under their control the

promotion of the company, and the company secretary as he is an important officer, is naturally consulted in the matter and takes an important part in the drafting thereof. The prospectus in usual form is printed on separate circulars and sent through post to all those who are likely to invest money in joint stock companies and many companies advertise same in the newspapers simultaneously. Where such a prospectus is to be published as a newspaper advertisement, it is not necessary in the advertisement to publish the contents of the memorandum of association or the signatories thereto or the number of shares subscribed for by them. [Section 93(2)]. This necessarily curtails an amount of expenditure which would otherwise be necessary in connection with the newspaper advertisements. Before dealing with other observations in connection with the drafting of this most important document, it is necessary to state that section 93 of the Indian Companies Act of 1913 makes it compulsory that every prospectus issued by or on behalf of a company or by or on behalf of any person who is or has been engaged or interested in the formation of the company must state :—

(a) the contents of the memorandum, with the names, descriptions and addresses of the signatories and the number of shares subscribed for by them respectively; and the number of founders or management or deferred shares (if any) and the nature and extent of the interest of the holders in the property and profits of the company; *and the number of redeemable preference shares intended to be issued with the date or, where no date is fixed, the period of notice required and the proposed method of redemption;* and

(b) the number of shares (if any) fixed by the articles as the qualification of a director, and any provision in the articles as to the remuneration of the directors; and

(c) the names, descriptions and addresses of the directors or proposed directors and of the managers or proposed managers *and managing agents or proposed managing agents* (if any) *and any provision in the articles or in any contract as to the appointment of managers or*

managing agents and the remuneration payable to them; and

(*d*) the minimum subscription on which the directors may proceed to allotment, and the amount payable on application and allotment on each share; and in the case of a second or subsequent offer of shares the amount offered for subscription on each previous allotment made within the two preceding years, and the amount actually allotted, and the amount (if any) paid on the shares so allotted; and

(*e*) the number and amount of shares and debentures which within the two preceding years have been issued, or agreed to be issued, as fully or partly paid up otherwise than in cash, and in the latter case the extent to which they are so paid up, and in either case the consideration for which those shares or debentures have been issued or agreed to be issued; and

(*ee*) *where any issue of shares or debentures is underwritten, the names of the under-writers, and the opinion of the directors that the resources of the under-writers are sufficient to discharge the under-writing obligations; and*

(*f*) the names and addresses of the vendors of any property purchased or acquired by the company, or proposed so to be purchased or acquired, which is to be paid for wholly or partly out of the proceeds of the issue offered for subscription by the prospectus, or the purchase or acquisition of which has not been completed at the date of issue of the prospectus, and the amount payable in cash, shares or debentures to the vendor, and where there is more than one separate vendor or the company is a sub-purchaser, the amount so payable to each vendor; Provided that where the vendors or any of them are a firm, the members of the firm shall not be treated as separate vendors; and

(*ff*) *where any property referred to in clause (f) has within the two years preceding the issue of the prospectus been transferred by sale, the amount paid by the purchaser at each such transfer so far as the information is available and, where any such property is a business, the profits accruing from such business during each of the three years immediately preceding the issue of the prospectus or during each year of the existence of the business if less than three years so far as the information is available. A balance sheet of the*

business concerned made up to a date not more than ninety days before the date of the issue of the prospectus shall be appended to the prospectus; and

(*g*) the amount (if any) paid or payable as purchase money in cash, shares or debentures, for any such property as aforesaid, specifying the amount (if any) payable for good-will; and

(*h*) the amount (if any) paid within the two preceding years or payable, as commission for subscribing or agreeing to subscribe, or procuring or agreeing to procure subscriptions, for any shares in, or debentures of, the company, *or as discount in respect of shares issued, showing separately the amount, if any, so paid to the managing agents;* Provided that it shall not be necessary to state the commission payable to sub-under-writers; and

(*i*) the amount or estimated amount of preliminary expenses; and

(*k*) the amount paid within the two preceding years or intended to be paid to any promoter, and the consideration for any such payment; and

(*l*) the dates of, and parties to, every material contract, *including contracts relating to the acquisition of property to which clause (f) applies,* and a reasonable time and place at which any material contract or a copy thereof may be inspected; Provided that this requirement shall not apply to a contract entered into in the ordinary course of the business carried on or intended to be carried on by the company, or to any contract (*except a contract appointing or fixing the remuneration of a managing director or managing agent*) entered into more than two years before the date of issue of the prospectus; and

(*m*) the names and addresses of the auditors (if any) of the company; and

(*n*) full particulars of the nature and extent of the interest (if any) of every director in the promotion of, or in the property proposed to be acquired by, the company, or, where the interest of such a director consists in being a partner in a firm, the nature and extent of the interest of the firm, with a statement of all sums paid or agreed to be paid to him or to the firm in cash or shares or otherwise by any person either to induce him to become, or to qualify him as, a director, or otherwise for services rendered by him or by the firm in

connection with the promotion or formation of the company; and

(*o*) where the company is a company having shares of more than one class, the right of voting at meetings of the company conferred by, *and the rights in respect of capital and dividends attached to the several classes of shares respectively;* and

(*p*) *where the articles of the company impose any restrictions upon the members of the company in respect of the right to attend, speak or vote at meetings of the company or of the right to transfer shares, or upon the directors of the company in respect of their powers of management, the nature and extent of those restrictions.*

(1A) Where the prospectus is issued by a company which has been carrying on business prior to the issue thereof, the prospectus shall set out the following reports in addition to the matters referred to in sub-section (1), namely :—

(i) a report by the auditors of the company with respect to the profits of the company including its subsidiary companies, if any, so far as the information is available in each of the three financial years immediately preceding the issue of the prospectus and with respect to the rates of the dividends, if any, paid by the company on each class of shares in the company for each of the said three years giving particulars of each such class of shares on which such dividends have been paid and the source from which the dividends have been paid and particulars of the cases in which no dividends have been paid on any class of shares for any of those years, and if no accounts have been made up for any part of a period of three years ending on a date three months before the issue of the prospectus, containing a statement of that fact;

(ii) if the proceeds or any part of the proceeds of the issue of the shares or debentures are or is to be applied directly or indirectly in the purchase of any business, a report made by an accountant or accountants holding the certificate referred to in section 144 who shall be named in the prospectus upon the profits of the business in respect of each of the three financial years immediately preceding the issue of the prospectus :

Provided that if, in the case of a company which has been carrying on business for less than three years, the accounts of the company have been made up only in

respect of two years or any shorter period, this sub-section shall have effect as if references to two years or such shorter period were substituted for references to three years.

(1B) The statement referred to in clause (ff) of sub-section (1) and the report referred to in sub-section (1A) with respect to the profits of a company or business shall show clearly the trading results and all charges and expenses incidental thereto excluding income or profits having no relation to the trading for the period covered and excluding also items of profit or income of a non-recurring nature but including amounts appropriated from profits to such purposes as payment of taxation or reserves.

(1C) Where any part of the sums required for the matters set out in sub-section (2) of section 101 is to be provided out of sources other than share capital particulars of the amount to be so provided and the sources thereof; and

(2) Where any such prospectus as is mentioned in this section is published as a newspaper advertisement, it shall not be necessary in the advertisement to specify the contents of the memorandum, or the signatories thereto, and the number of shares subscribed for by them.

(3) This section shall not apply to a circular or notice inviting existing members or debenture holders of a company to subscribe either for shares or for debentures of the company, whether with or without the right to renounce in favour of other persons.

(4) The requirements of this section as to the memorandum and the qualification, remuneration and interest of directors, the names, descriptions and addresses of directors or proposed directors, and of managers or proposed managers, and the amount or estimated amount of preliminary expenses, shall not apply in the case of a prospectus issued more than one year after the date at which the company is entitled to commence business.

Provided that the said requirements, except the requirement as to the amount or estimated amount of preliminary expenses, shall apply to a prospectus filed in pursuance of section 154.

(5) Nothing in this section shall limit or diminish any liability which any person may incur under the general law or this Act apart from this section.

NOTE :—The italics are amendments under the Amending Act of 1936.

How to scan the Prospectus

It will be thus noticed that as far as possible, the Indian Companies Act, 1913, as amended in 1936, has provided proper safeguards in order that the investing

public may not be misguided or misled, by insisting on details being stated in the prospectus, which are likely to affect their judgment while deciding whether or not they should apply for shares in a proposed company. If in actual practice these safeguards prove to be inoperative, the fault lies with the investors who generally allow themselves to be carried away either by sentiment or by the speculative fever conveniently let loose by interested promoters and their friends. Even among the most sober-minded investors, the proportion of those who base their conclusions on a careful study both of the prospectus and the articles of association of the company, they invest in, is very small indeed. The primary object of the prospectus is, of course, to induce the public to subscribe for the shares and debentures of the company and thereby secure the necessary money which is to make up the capital of the company. The greatest care, therefore, should be taken here to state all the points which a cautious investor is likely to be curious about and that too, with the utmost veracity. The investing public of all countries where joint stock companies have flourished for some length of time, have had their experience of both the good and the doubtful type of enterprises which has made them rather unduly sceptical. Even so prominent a writer and thinker as Mr. Hartley Withers has thought it fit to write about prospectuses in his book on "Stock and Shares" as follows :—

> "All prospectuses should be scanned in a spirit of jaundiced criticism and with the most pessimistic readiness to believe that they are specially alluring traps laid by some designing financier to relieve the reader of some of his money. No allowances should never be given to the Prospectus. In fact, a large number of them are quite reasonable propositions put forward by quite honest men, but when they are of this kind they will, or ought to stand the most sceptical scrutiny, and when they are not, it is a service to the community at large to put them as quickly as possible in the waste paper basket."

Care in its Preparation

The prospectus should therefore disclose all the material points in order to disarm all possible chances of suspicion which are likely to discourage an investor. In case where a going concern is to be taken over by the new company, the actual working results in form of net profits for a number of years immediately preceding the period ought to be stated in the form as required by section 93(*1*) *ff.*, *i.e.*, the profits accruing from such business during each of the three years immediately preceding the issue of the prospectus, or during each year of the existence of the business if less than three years, so far as the information is available, should be disclosed. A balance sheet of the business concerned made up to a date not more than ninety days before the date of the issue of the prospectus, must be appended to the prospectus. These statements should be, for inspiring public confidence, certified by a well-known firm of accountants and if possible an extract from the report of such accountants as to these profits should advantage be quoted in the prospectus. The form in which these profits are disclosed should be such as to make it clear that the business sought to be purchased was of a progressive character. In the case of assets taken over they ought to be valued by recognised experts. The name of the auditors should also be stated wherever possible and in the selection of these, care should be taken to pick out qualified men of reputation and standing. Besides observing these precautions, all frankness ought to be displayed in carefully describing the business which the company is to carry on. A cautious investor will not blindly stake his capital in an enterprise without carefully weighing the possibilities of the business in contemplation and therefore all possible attention should be given to the work of supplying him with all possible materials which are likely to help him to judge for himself after considering fully the point of view of the promoters. The promoters should also take care to see that as far as possible all the statements contained in the prospectus are

based on some expert's reports, abstracts from official documents, or on facts which they are able to substantiate if called upon. All the requirements of the Companies Act, 1913, as dealt with above, ought also to be strictly observed. Failing this, every director, promoter and every person, who is knowingly responsible for the issue of such prospectus shall be liable to a fine not exceeding Rs. 50 for every day from the date of the issue of the prospectus, until a copy complying with the requirements of section 93 is filed, besides this every director, promoter and officer of the company, with whose consent and knowledge the prospectus was issued, lays himself open to be sued for damages by an aggrieved shareholder, who purchased or agreed to purchase, the shares relying on any untrue or misleading statement in the prospectus.

Mr. Hartley Withers whom we have already quoted above, recommends the investor to pay particular attention to the name of the firm of brokers (if any) mentioned in the prospectus, as a good firm of brokers will not attach itself to a doubtful company, still less recommend its clients to invest in the same. He also recommends investors in general to consult their own brokers before deciding on the prospects of an undertaking in which they think of investing. This of course applies to brokers in England, particularly, to those on the London Stock Exchange, where the members of the Exchange are divided into two watertight compartments known as "Jobbers" and "brokers." The former class restricts itself to buying and selling in stocks, shares and securities, whereas the latter acts as a middleman between the jobber and the investing public. In other words a jobber cannot act as a broker and *vice versa*. Under these circumstances a broker being a disinterested middleman, besides being an expert in the line, can no doubt be looked to with confidence for advice. In India however no such distinction is observed. Almost every broker on the Stock Exchange, whether in Bombay or elsewhere, is also a dealer in stocks,

shares and securities, and therefore, one can never be certain about the extent of the disinterestedness of his advice. The most prominent of these brokers indulge in the underwriting of share capital, which they would naturally be anxious to unload at the first possible opportunity. However honest and straightforward their methods of business may be, this conflict of interest should alone be sufficient to deter a cautious investor from looking for guidance from this quarter. From a practical promoter's point of view, however, the insertion of the name of a well-known firm of brokers wherever possible, makes the prospectus more attractive both here as well as in England.

The other attraction which has generally proved overpowering to an average investor is the inclusion of a few titled names among the board of directors. It need only be added that according to the best authorities the glare of titled names on a board is losing its magnetic effect on the average investor in England who has improved by experience, and no doubt the same transition seems well within sight in India.

Observations on the Draft of a Prospectus

The first point in connection with the contents of the prospectus is that the contents of the memorandum of association should be stated in the prospectus, which means that everything with the exception of the signatures of witnesses is to be set out. In order to avoid the prospectus getting into a confused document, there is the present practice to print the contents of the memorandum of association in the fold of the prospectus and to refer to same in the body of the prospectus itself. The prospectus has to be dated and signed, which date, unless the contrary is proved, should be taken as the date of filing of the prospectus. Before filing of the prospectus it must be signed by every person named as director or proposed director, or failing the signatures of the directors, by any persons duly authorised to sign on their behalf.

The other requirement is that every prospectus issued to the public must state on the face of it that a copy of it has been so filed with the registrar of joint stock companies. These requirements of section 93 of the Indian Companies Act, 1913, cannot be restricted by any condition requiring or binding any applicant either for shares or debentures to waive compliance with them or by purporting to affect him with notice of any contract, document or matter not specifically referred to in the prospectus. If such a term is sought to be imposed the same shall be void (S. 96).

To summarise, the prospectus must be so drafted as to answer the various requirements of the law at the same time it should be sufficiently attractive from the point of view of publicity and good salesmanship and for that purpose should not only place the case of the company in an attractive manner without exaggeration, misrepresentation, omissions or ambiguity, but should also, embrace names of directors, managers, and managing agents. It is also usual to state the names of bankers, lawyers, brokers and auditors in the prospectus though not compulsory in order to inspire public confidence. The prospectus must not only state with strict and scrupulous accuracy all the facts on which the would-be shareholders are likely to rely in arriving at their judgment, but should omit none within the knowledge of the promoters, the existence of which might in any degree affect the nature or extent or quality of the privileges and advantages which the prospectus holds out as inducements to take shares (*New Brunswick etc. & Co.* v. *Muggeridge,* (1860) 1 *Dr. and Sm.* 363.)

In the opinion of *Lord Chemsford* in *Central Railway of Venezuela* v. *Kisch, L. R.* 2 *H. L.* 123, though the prospectus may have been highly coloured, or contains exaggeration as far as the description of advantages to be enjoyed by the shareholders is concerned, there should not be misstatement or concealment of any material facts or circumstances. Even where half the fact is stated

and the other half withheld which makes the prospectus absolutely false, that may fall under deceit (*Peek* v. *Gurney, L. R.* 6 *H. L.* 403). The other point to be remembered is that even though there may not be any dishonest intention, but if those publishing a prospectus use careless language with the result that their statements when literally read become untrue, although this literal sense is different from what they intended, it amounts to a misrepresentation (*Hallows* v. *Fernie,* 3 *Ch.* 476). This principle has been reiterated by eminent judges in similar cases.

The Usual Practice at Registrar's Office

The usual practice of the registrar of joint stock companies is to require all prospectuses presented to him for registration to be printed, so that he can be sure of the copies circularised among the public being uniform. The best course is that when the prospectus is in the course of printing and the fair proof is ready, it may be handed to the registrar for scrutiny and comment so that if there are any errors, same may be pointed out by the office and corrected in time. Of course the registrar does not take any responsibility in this connection and the fact that the prospectus had been approved and filed does not mean or imply that the document is in order. The legal responsibility is on the person who presents same for responsibility is on the person who presents same for filing.

Model Form of Prospectus

Note :—For model form of the prospectus of a joint stock company see Vol. II, Appendix A and Index.

Contents of the Memorandum

Here what the law requires is that the prospectus must contain the whole of the memorandum except the signature of the witnesses. As this is likely to make the prospectus rather cumbersome, a practice has grown up to give the memorandum in the fold of the prospectus which does not seem to be objectionable.

The points of importance in connection with the above section are that now that the Amending Act of 1936 permits redeemable preference shares to be issued, the prospectus is required to state the number of redeemable preference shares intended to be issued with the date or where no date is fixed, the period of notice required and the proposed method of redemption.

Names and Description of Managing Agents

With reference to the names, description and addresses of directors, proposed directors and managers or proposed managers being disclosed, the Amending Act now requires in addition that managing agents or proposed managing agents should also be disclosed. This is due to the fact that now under the Amended Act, managing agents are specifically defined and special provisions are inserted in the Act as to their rights and responsibilities. Thus in case of managing agents and managers it is now necessary that if there is any provision in the articles of association or in any contract as to the appointment of managers or managing agents and the remuneration payable to them, the same should be disclosed in the prospectus.

Minimum Subscription

Under the old Act it was necessary only to mention a sum in the prospectus as " minimum subscription " which if applied for, the directors could go to allotment. The actual figure was left to the option of the promoters and directors. It was hoped that the promoters would be tempted to put in a fairly substantial amount with a view to inspire confidence and that if they put in an absurdly small amount, on which they purported to proceed to allotment, the public would hesitate to apply. However, in practice it was discovered that in good times and in many cases in normal times also, this safeguard was inoperative and insufficient. The reckless attempt to promote all sorts of companies and to float them with insufficient capital continued and simple-minded people were

in one form or other, enticed, in purchasing shares even in case of companies openly floated with insufficient finance.

The Green Commission of 1925-26 in its Report on Company Law Amendment of England lays down that "the existing law as to minimum subscription has become in practice useless owing to the low minimum which is usually fixed in articles of association. We consider that an alteration in the law should be made so as to bring it as nearly as possible within the original intention of the legislature." Thus now our Amended Companies Act in Section 101 (*1*), (*2*) and (*2a*) lays down that :—

" (1) No allotment shall be made of any share capital of a company offered to the public for subscription unless the amount stated in the prospectus as the minimum amount which in the opinion of the directors must be raised by the issue of share capital in order to provide the sums or, if any part thereof is to be defrayed in any other manner, the balance of the sum required to be provided in respect of the matters specified in sub-section (*2*) has been subscribed, and the sum of at least five per cent. thereof has been paid to or received in cash by the company.

(2) The matters for which provision for the raising of a minimum amount of share capital must be made by the directors are the following, namely :—

(*a*) the purchase price of any property purchased or to be purchased which is to be defrayed in whole or in part out of the proceeds of the issue;

(*b*) any preliminary expenses payable by the company and any commission so payable to any person in consideration of his agreeing to subscribe for or of his procur-

ing or agreeing to procure subscriptions for any shares in the company.

(*c*) the repayment of any moneys borrowed by the company in respect of any of the foregoing matters, and

(*d*) working capital.

(*2a*) The amount referred to in sub-section (*1*) as the amount stated in the prospectus shall be reckoned exclusively of any amount payable otherwise than in cash and is in this Act referred to as the minimum subscription.

The same section 101 (*2c*) further lays down that—

"In the event of any contravention of the provisions of sub-section (*2b*) every promoter, director or other person knowingly responsible for such contravention shall be liable to a fine not exceeding five hundred rupees."

The object sought to be achieved by these provisions of section 101 is to prevent the formation of what are called "mushroom companies" with insufficient finance.

Disclosure as to Vendors and the Purchase Price

With regard to the vendors who sell the property to the company which they had originally purchased in their own name, the section requires that complete disclosure should be made of their names and addresses and that too not only of the vendors but of sub-vendors also together with the statement as to the amount which each one of them is to receive, in cash, shares or debentures. Where this property has within the two years preceding the issue of the prospectus been transferred by sale, the amount paid by the purchaser at each such transfer, so far as the information is available, should also be stated. Where any such property is a business the profits accruing from such business during each of the three years immediately preceding the issue of the prospectus, or during each year of the resistance of the business if less than three years

should be disclosed as far as information is available [S. 93(*1*) (*ff*)]. The amount (if any) paid or payable as purchase money in cash, shares or debentures, for any such property should also be stated, specifying the amount (if any) payable for good-will. [S. 93(*1*) (*g*)]. The term "vendor" according to S. 94 includes any person who has entered into any contract absolute or conditional, for the sale or purchase, or for any option of purchase of any property to be acquired by the company in any case, where—

(*a*) the purchase money is not fully paid at the date of issue of the prospectus; or

(*b*) the purchase money is to be paid or satisfied wholly or in part out of the proceeds of issue offered for subscription by the prospectus; or

(*c*) the contract depends for its validity or fulfilment on the result of that issue.

If the vendors happen to be a firm, it is not necessary to distinguish the amount receivable by the respective partners. Where the company purchases the benefit of an existing contract, it will be necessary to state both the price paid for such benefit and the price payable by the "vendor" under the contract (*Brookes* v. *Hansen*, (1906) 2 *Ch.* 129). Where any of the property to be acquired by the company is to be taken on lease, the expression "vendor" shall also include the lessor and the expression "purchase money" will include consideration for the lease and the expression "sub-purchase" will include the sub-lessee (S. 95).

Disclosure of Material Contracts

Here the contracts meant are those to which the company, or some persons having direct relation with it such as vendors, promoters, directors or officers are parties to it. The material contract is defined by Baggallay, L.J., in *Sullivan* v. *Mitcalfe* (1880) 5 *C. P. D.* 465 as those which "shown in a reasonable construction of

its purport and effect would assist a person in determining whether he should become a shareholder in the company." It may also mean " calculated to influence persons reading a company's prospectus in making up their mind whether or not they will apply for shares" (*Twycross* v. *Grant*, (1877) 2 *C. P. D.* 485). The following contracts for example would be considered material :—

1. Contract to pay a commission or give some other advantage to the promoters in connection with the formation of the company.
2. A contract by the company to purchase any property or by its promotors or others even though the purchase has not been completed.
3. A contract to resell to the company at a profit any property.
4. Any other contract under which the promotors or directors are making some profits or getting some advantage at the expense of the company.
5. Contracts relating to the acquisition of property.
6. A contract appointing and fixing the remuneration of a managing director or managing agents.

The following contracts are exempted from the provisions of this section :—

1. Those entered into in the ordinary course of business which is carried on by the company or intended to be carried on by the company.
2. Contracts entered into more than two years before the publication of the prospectus except contracts appointing or fixing remuneration of a managing director or managing agents.

3. Where prospectus is published more than one year after the date on which the company is entitled to commence business.

Interest of Directors

The section 93 makes it compulsory that particulars of the nature and extent of the interest of every director in the promotion or property proposed to be acquired by the company must be disclosed. Full particulars of this disclosure are required so that the subscribers are able to judge the extent to which the directors who call upon them to subscribe are interested in the company or its contracts. Thus a simple statement that the directors are interested will not be sufficient, but particulars of the nature and extent of their interest must be given (*Empire Assurance* v. *Coleman,* 6 *Ch. D.* 568).

On this point of interest, all contracts made by directors with the company which are likely to bring them any profit, benefit, or gain, must be strictly disclosed in the prospectus and no question is allowed to be raised as to the fairness or unfairness of the contract in question (*Parker* v. *McKenna,* 10 *Ch.* 96 *at p.* 118). Where for example the secret profits made by the directors who are also promoters, consisted of shares which had never been validly issued, the promoter was held to be liable (*Jubilee Cotton Mills,* (1923) 1 *Ch. I*). The principle on which this rule is based is that in all cases where a person is either actually, or constructively, an agent for other persons all profits and advantages made by him in the business beyond his ordinary compensation are to be for the benefit of his employers (*Morison* v. *Thompson,* (1874) *L. R.* 9 *Q. B. at p.* 487). Thus where directors secretly receive from a promoter shares by way of a gift the company was entitled to claim either the shares or in case of those shares which were afterwards sold by the directors the whole profit and where no profit has been made such sum as the company lost by reason of its being deprived of the right of allotting these shares

to others who would have paid for them (*Carling's Case*, (1876) 1 *Ch. D.* 115).

Liability for not filing or omission of requisite particulars

If a prospectus of a public company is issued without a copy being filed Sec. 92 provides that every person who is knowingly a party to the issue of the prospectus, shall be liable to a fine not exceeding Rs. 50 for every day from the date of the issue of the prospectus until a copy thereof is filed.

As to omission of the particulars which section 93 requires to be given in the prospectus the remedy of a shareholder who purchases his share relying on the prospectus is damages against the persons responsible for the prospects (*South of England Natural Gas Co.*, (1911) 1 *Ch. D.* 573). But it should be noted that the mere fact that the prospectus omits some of the facts or contracts required to be stated by section 93 does not entitle a shareholder to rescission and rectification of the register. In other words the shareholder is to claim those damages which he has to prove and not rescission (*Wimbledon Olympia Ltd.*, (1910) 1 *Ch. D.* 630). If there are omissions of matters in the prospectus which it was the duty of the promoters to disclose whereby the said omissions became equivalent to misstatements and damage was caused the promoters would be liable (*David* v. *Britannic Merthyr Coal Co.*, (1909) 2 *K. B.* 157).

General Observations as to Prospectus

It was held in *Booth* v. *New Africander Gold Mining Co., Ltd.*, (1903) 1 *Ch. D.* 295, that an offer to the members of an old company, of shares of the new company which was merely the re-construction of the old concern, was not an offer to the public. Considerable doubt is thrown with regard to the soundness of this proposition. In another Scottish case where a promoter sent through his friends and customers an offer to purchase

shares, it was held that the said offer was not made to the public. *In Sherwell* v. *Combined Incandescent Mantles Syndicate,* (1907) 23 *T. L. R.* 482, where the prospectus was printed by a set of promoters and marked "strictly private and confidential" it was held that the offer was not made to the public. In this case it was further laid down that in order to constitute an offer to the public, the offer should be made to any one who chooses to come in and apply for shares.

Public Offer

As to what is a public invitation to buy shares or when is the prospectus in law issued to the public, the decisions show that "whether or not the capital had been offered to the public was a pure question of fact........ It meant............an offer of shares to any one who should choose to come in" (*Sherwell* v. *Combind Incandescent Mantles Syndicate,* (1907) *W. N.* 110). On the question of what constitutes the public, an offer by a promoter to a few of his friends, relations or customers has been held not to be an offer to the public (*Sleigh* v. *Glasgow and Transvaal Options,* (1904) 6 *F.* 420 (*7th Ser*). *No.* 70 *Ct. of Sess.*) In one other case where some 3,000 copies of a prospectus marked "for private circulation only" were printed and issued to the shareholders of gas companies in which the promoter was interested, *Swinfen, J.*, held that the prospectus was issued to the public (*In South of Englend Natural Gas Co.,* (1911) 1 *Ch.* 573). On the same principle two prospectuses or statements were held to be issued to the public and it was laid down that it was not necessary that issue should be made to persons invited to subscribe. The words issued to the public are not in the section (*Lynde* v. *Nash,* (1928) 2 *K. B.* 93).

Underwriting Commission

What section 93 (*h*) requires here is a statement showing what commission (if any) has been paid during

two preceding years, or is payable for subscribing or agreeing to subscribe or procuring or agreeing to procure subscriptions for any shares in or debentures of the company, or as discount in respect of shares issued showing separately the amount, if any, so paid to the managing agents, provided that it shall not be necessary to state the commission payable to sub-underwriters. Thus all possible commission payable has to be disclosed in the prospectus, over and above the underwriting commission and the commission payable to subscribers. It is further laid down that where any issue of shares or debentures is underwritten, the names of the underwriters and the opinion of the directors that the resources of the underwriters are sufficient to discharge the underwriting obligations should also be stated [S. 93 *(1)* *(ee)*]. The latter sub-section is introduced to prevent bogus underwriting by persons of doubtful means. It frequently happens that previous to the making of an offer by the company, some person, or persons, or a syndicate enters into an agreement called "underwriting agreement" by which they undertake in consideration of a certain commission being paid to them on capital offered for public subscription, to take up and pay for such of the shares as are not taken up by the public. Thus it will be noticed that the most important requisite in case of an underwriting agreement is that there ought to be a public offer, which is so to say underwritten, or insured against, by this agreement and thus the promoters are assured of a successful floatation of the enterprise as far as its capital is concerned. The Companies Act (Sec. 105) makes it lawful for a company to pay the commission to any person for subscribing, or agreeing to subscribe, procuring or agreeing to procure subscription, provided that the payment of such commission is disclosed in the prospectus. With regard to underwriting, the leading case is *Re : Licensed Victuallers' Mutual Trading Association,* (1889) 42 *Ch. D.* 1. Here in the opinion of *Cotton, L.J.*, an underwriting agreement is "an agreement entered into before the shares

are brought before the public that in the event of the public not taking up the whole or the number mentioned in the agreement, the underwriter will, for an agreed commission, take the allotment for such part of the shares as the public has not applied for." The consideration, *i.e.*, the underwriting commission must be paid whether the underwriters are called upon to take up and pay for any shares under the agreement or not. In the same case *Lindley, L.J.*, also expressed himself thus : "Underwriting in this connection, in business means agreeing to take so many shares more or less in number as are specified in the underwriting letter if the public do not subscribe for them. There is no doubt that that is the meaning of underwriting." It will therefore be observed that an agreement which does not fall under any one of these definitions is not strictly speaking an underwriting agreement. But the section 105 now makes it lawful for a company to give commission out of its capital money for subscribing for shares, as opposed to procuring subscription, irrespective of the fact whether the public offer has been made or not. The payment of commission on debentures, or the issue of same at discount, is not forbidden, but it was held in one case, *viz.*, *Moseley* v. *Koffyfontein Mines*, (1904) 2 *Ch.* 108, where debentures were originally issued at a discount, and later the same were attempted to be exchanged for fully paid shares that the issue was bad, as it was an issue of shares at a discount. With regard to brokerage, however, our section 105 leaves the companies power to pay same "as it has heretofore been lawful for a company to pay." An agreement to take up shares must be distinguished from an agreement to place shares as in the latter case the party agreeing is not bound to take up shares he fails to place (*Gorrissen's Case,* (1873) *L. R.* 8 *Ch. Ap. Cas.* 507). Failure to disclose commission makes the payment illegal and even after allotment of shares an agreement to pay commission not disclosed cannot be enforced (*Andreae* v. *Zinc Mines of Great*

Britain, (1918) 2 *K. B.* 454). The underwriting letters generally authorise the company or persons acting for it, to apply in the name of the underwriter or sub-underwriter for the shares in case they fail to apply when called upon to do so. This letter is an authority coupled with interest and therefore after acceptance by the promoters is irrevocable (*Carmichael's Case*, (1896) 2 *Ch.* 643; *Olympic Re-Insurance Co.*, (1920) 2 *Ch.* 341.) Even death of the underwriter does not terminate the authority (*Carter* v. *White*, (1884) 25 *Ch. D.* 666). The underwriting contract can be enforced against the executors of the underwriter because it is not a personal contract to die with the person even though the duty imposed is to find capital (*Warner Engineering Co.* v. *Brennan*, (1914) 30 *T. L. R.* 191; *Re : Worthington Ex parte Pathe Freres*, (1914) 2 *K. B.* 299), where the words " when called upon " are used the underwriter must have been called upon to subscribe in the first instance (*Harvey's Oyster Co.*, (1894) 2 *Ch.* 474; *Ex parte Cox-Huges*, (1896) 75 *L. T.* 669). Where an underwriter signed his letter before company was formed, but to the knowledge of the directors he relied on a draft prospectus, he can be relieved if there was misrepresentation in the said draft prospectus (*Baty* v. *Keswick*, (1901) 85 *L. T.* 18).

Where Prospectus is not issued

In case of a private company there is no question as to a prospectus, because they cannot make an offer to the public to take up the shares and thus the requirements as to a prospectus do not apply to them. In case of a public company, however, when it does not issue a prospectus for the simple reason that it has managed to get its shares subscribed by private arrangements, the Act requires a " statement in lieu of prospectus " to be made out and filed with the registrar which should be signed by every person who is named in such a statement as a director or a proposed director of the company or by his agent authorised to sign in his behalf (S. 98).

The object here is that where the prospectus is not issued an applicant can inspect this statement which gives the same particulars as the prospectus gives and arrive at a decision as to whether he should apply for shares or not This "statement in lieu of prospectus" must be filed before the directors make the first allotment of the shares or debentures of the company. The Act is however silent as to whether an allotment of shares or debentures before the filing of the statement is void or voidable, but it was decided in the Court of Appeal by the majority that in such a case the issue of shares before filing of statement is void (*Jubilee Cotton Mills* v. *Lewis*, (1924) *A. C.* 958). Where a company allots or agrees to allot any shares in or debentures of the company with a view to all or any of those shares or debentures being offered for sale to the public, any document by which the offer for sale to the public is made shall for all purposes be deemed to be a prospectus. [S. 98A (*1*)].

It may be added here that the requirement of the Companies Act in connection with the prospectus was sought to be avoided by the promoters and directors of some companies by arranging, in league with certain individuals, to make a private subscriptions by allotting to them blocks of shares in the first instance which they could themselves afterwards advertise for sale to the public without being compelled to observe the requirements of section 93 as to the prospectus and a public issue.

The Green Commission of 1925-26 of England in their report pointed this out and made recommendations which, according to them, was "designed to hit those cases and those cases only where the offer is or may properly be deemed to be made in complicity with the company itself." They further stated that their recommendations "will not affect cases where the independent holder of a block of shares desires to realise them by means of a public offer." Thus it will be noticed that groups of financiers who take up block of shares and offer them for sale will fall under the new section 98A (*2*), unless their

operation is entirely independent of the promoters or directors. This section is worded as follows :—

Sec. 98*A* (*2*) For the purposes of this Act it shall, unless the contrary is proved, be evidence that an allotment of or an agreement to allot shares or debentures was made with a view to the shares or debentures being offered for sale to the public, if it is shown—

(*a*) that an offer of the shares or debentures or of any of them for sale to the public was made within six months after the allotment or agreement to all; or

(*b*) that at the date when the offer was made the whole of the consideration to be received by the company in respect of the shares or debentures had not been so received.

Disclosures by an Existing Company Offering New Shares for Subscription

The other most wholesome and necessary amendment is the insertion of sub-section 1A to Sec. 93 which applies to a prospectus issued by a company which has been carrying on business for some time and wants further share capital. There was no satisfactory provision under the old Act which compelled the directors or managing agents of companies offering a new set of shares or debentures to the public to disclose exactly what the present position of the company concerned happened to be. Thus it is laid down here that the prospectus shall set out in addition to the matters referred to in Sec. 93 (1) the following reports, *viz.*—

(1) A report by the auditors of the company with respect to the profits of the company including its subsidiary companies, if any, so far as the information is available in each of the three financial years immediately preceding the issue of the prospectus and with respect to rates of dividends, if any, paid by the company on each class of shares in the company for each of the said three years giving particulars of each such class of shares on which such dividends have been paid and the sources from which the dividends have been paid. In case no dividends

have been paid, the particulars of such cases must also be stated. If no accounts have been put for any part of a period of three years ending on a date three months before the issue of the prospectus, a statement has to be made of this fact,

(2) In case the proceeds of the issue of shares or debentures offered to the public by such a prospectus are to be applied directly or indirectly in purchase of any business, it is further provided that a report made by a qualified accountant (who shall be named in the prospectus) upon the profits of the business in respect of each of the three financial years immediately preceding the issue of the prospectus must be given in the prospectus. In case such a business was carrying on business for less than three years, then in case the accounts have been made up only in respect of two years or any shorter period, the report of the auditor shall relate to such shorter period, the reports of profits must show clearly the trading results and all charges and expenses incidental thereto and must exclude therefrom any income or profits which have no relation to the trading for the period covered. The items of profits or income of a non-recurring nature have also to be excluded from such profits.

Offer for Sale to be Deemed a Prospectus

In England a practice had grown up with a view to avoid the strict requirements of the law with regard to the disclosures in the prospectus, with the result that the public was deprived of the protection which the legislator intends to grant it. This was commonly known as "Offer for sale." Under this a syndicate or a number of persons took up a block of shares of a company and then offered same to the public for subscription. Under the law, this offer for sale to the public by these persons did not come under Sec. 93 of the Act and thus the provisions of the Act were avoided. It is now laid down following the corresponding section of the English Act that *where a company allots or agrees to allot any shares or debentures with*

a view to all or any of the shares or debentures being offered for sale to the public, any document by which the offer for sale to the public is made shall for all purposes be deemed to be a prospectus issued by the company and all enactments and rules of law as to the contents of the prospectus and to liability in respect of statements and omissions from prospectuses shall apply and have effect accordingly as if the shares or debentures had been offered to the public for subscription. If persons accepting the offer in respect of these shares and debentures become subscribers of such shares or debentures, the parties who issued such a prospectus would be liable in respect of misstatements contained in such a document. (Sec. 98A).

Misrepresentation in the Prospectus

In this case the ordinary law of misrepresentation in connection with a contract naturally applies with all the incidents relevant to same. In order to appreciate fully the exact significance of what is misrepresentation, this portion of Contract Law may be cited. Misrepresentation is defined by section 18 of the Contract Act as meaning and including—

(1) any positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;

(2) any breach of duty which, without an intent to deceive, gains an advantage to the person committing it, or any one claiming under him, by misleading another to his prejudice, or to the prejudice of any one claiming under him;

(3) causing, however innocently, a party to an agreement to make a mistake as to the substance of the thing which is the subject of the agreement (Sec. 18).

Fraud, on the other hand, is defined as meaning and including any of the following acts committed by a party to a contract, his agent, or by his connivance with intent to deceive another party, or his agent, or to induce him to enter into the contract—

(1) a suggestion as to the fact, of that which is not true by *one who does not believe it to be true;*
(2) the active concealment of a fact by one having knowledge or belief of that fact;
(3) a promise made without any intention of performing it;
(4) any other act fitted to deceive;
(5) any such act or omission as the law specially declares to be fraudulent.

Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud unless the circumstances of the case are such that regard being had to them, it is the duty of the person keeping silent to speak, or unless his silence is, in itself, equivalent to speech. Misrepresentation of law not being a misrepresentation of fact, does not give any remedy against the directors (*Beattie* v. *Lord Ebury,* (1872) 7 *Ch.* 777); *Bently* v. *Black,* (1893) 9 *T. L. R.* 580).

Misrepresentation and Fraud

Misrepresentation is, to sum up briefly, any untrue statement made by a party to the contract to another which is a material statement of fact and not of law and which induced the other party to act upon the statement and enter into the contract. In India a positive assertion as to law would also fall under that heading. Misrepresentation may be either (1) innocent or (2) fraudulent. It is innocent when the party who made that statement honestly believed at that time that it was true, but it turns out afterwards to be false. The remedy for innocent misrepresentation where no intention to deceive exists, is rescission of the contract and restitution. (*Blair Open Hearth Furnace Co.,* (1914) 1 *Ch.* 390). Stranger has the same right to repudiate the contract for taking up the shares like any other subscriber for shares if he took them upon the faith of a prospectus containing untrue statements (*Karberg's Case,* (1892) 3 *Ch.* 1). There must be some active misstatement of fact to support an action for deceit (*Peek* v. *Gurney,* (1874) *L. R.* 6 *H. L.* 377 *at*

p. 403; *Derry* v. *Peek,* (1889) 14 *A. C.* 337). As to suppression of fact from the prospectus the suppression should be such as to falsify the prospectus (*Hymann* v. *European Central Ry. Co., Eq.,* 154; *Aaron's Reef* v. *Twiss,* (1896) *A. C.* 273). In the last-named case it was laid down that a half truth may be tantamount to a false statement if represented as a whole truth. See also *Greenwood* v. *Leather Shod Wheel Co.,* (1900) 1 *Ch.* 421; *Rex.* v. *Kylsant,* (1932) 1 *K. B.* 443. In last-named case, *viz.,* Kylsant's case, it was decided that a prospectus made out to disclose the true position as to profits and dividends makes such a partial disclosure as to be misleading may be false in a material particular. It must however be noted that the party misrepresented must apply for his remedy in good time (*Petroleum Co.,* (1883) 2 *Ch. D.* 413). Only the shareholder who applied for shares on the faith of the prospectus is entitled to relief but the purchaser from and the shareholder cannot claim relief on the ground of misrepresentation in the prospectus, because the office of the prospectus is exhausted, once the allotment is made (*Peek* v. *Gurney,* (1874) *L. R.* 6 *H. L.* 337). A subscriber who repurchases after selling his shares also cannot obtain relief (*Groom's Case,* (1873) 16 *Eq.* 417). Such an innocent misrepresentation does not give any right to damages. In this case, the fact that the party misrepresented had the means of discovering the truth would be a good defence but in case of fraud no such defence would lie with the defrauding party (*Reynell* v. *Sprye,* (1851) 1 *De G. M. & G.* 660; *Arkwright* v. *Newbold,* (1881) 17 *Ch. D.* 310; *Gluckstein* v. *Barnes,* (1900) *Ap. Cas.* 240).

In case of fraud, however, a false statement is made wilfully and with the intention to deceive. The injured party would have the right both of avoiding the contract, *i.e.,* rescission and of suing for damages.

Both misrepresentation and fraud make a contract voidable at the option of the party wronged by the misrepresentation. In case of fraud, however, the party

defrauded gets the additional remedy of suing for damages brought about by such a fraud. Whereas in case of innocent misrepresentation the only remedies are rescission and restitution.

To make the company responsible on misrepresentation in the prospectus the party suing must prove that it was issued by the company or by someone with the authority of the company (*National Exchange Co. of Glasgow* v. *Drew*, (1855) 2 *Macq.* 103; *Holdsworth* v. *City of Glasgow Bank*, 5 *Ap. Cas.* 317). In case where the prospectus was originally issued by the promoters and thereafter has been ratified by the board the company would be responsible (*Pulsford* v. *Richards*, 17 *Beav.* 97). A foreigner who subscribes on the faith of an abriged prospectus published abroad can also sue for misrepresentation (*Roussell* v. *Burnham*, (1909) 1 *Ch.* 127).

The law with regard to this point is to be found under Sec. 100 of the Indian Companies Act, 1913. According to this section every person who is a director, or who has authorised himself to be named as a director, and every person who has authorised the issue of the prospectus will be bound to compensate all persons who relying on the statements in the prospectus which were untrue, and misleading apply for shares and suffer loss. The statement complained of should be material and should be one of fact and not of law, unless it is the law which does not apply to British India, and further the applicant for shares has to show that he relied upon the statement while he made his application. In case it happens that though no one particular statement can be challenged as false, or misleading if the contents of the prospectus are of such a nature, that if a number of statements were to be taken together, they would create a false impression, the prospectus would be none the less considered misleading. Of course the party aggrieved must come for his remedy within a reasonable time of his coming to know of the falsity of the statement (*Aaron's Reef Ltd.* v. *Twiss*, (1896) *A. C.* 273).

Points to be Established

The points that should be established are :—

(1) That the misstatement complained of was made by the company, or on its behalf;

(2) That the said misstatement was material;

(3) The applicant came for his remedy within a reasonable time and before winding up commenced; and

(4) That he relied upon the statement while taking up shares.

Innocent Misrepresentation

It must however be noted that if an altogether incorrect statement is made in the prospectus, and the directors honestly believed it to be true, but which afterwards turned out to be untrue, they shall not be responsible for damages in a case for deceit. (*Derry* v. *Peek*, (1889) 14 *A. C.* 337).

WHO CAN SUE AND BE SUED

On the question as to whether the original allottees alone can sue the directors on the ground of misrepresentation or fraud in the prospectus, there are two conflicting decisions, *viz.*, the one in *Peek* v. *Gurney*, (1874) *L. R.* 6 *H. L.* 377, where it was held that persons who buy shares on the markets as distinct from those who apply originally, cannot sue relying on the prospectus because the "office of the prospectus is exhausted," as soon as the shares are allotted. Whereas in another leading case, *viz.*, *Andrews* v. *Mockford*, (1896) 1 *Q. B.* 372, where the prospectus had been persistently circulated on the market it was held that even the subsequent allottee, who acted upon the strength of the prospectus and purchased shares, was entitled to sue on the aforesaid ground. It may be added that a subscriber to a memorandum of association cannot escape liability by pleading misrepresentation with respect to the shares he has agreed to take up by his subscription for the simple

reason that the company before its existence could not have agents to represent. (*Metal Constituents Ltd.*, (1902) 1 *Ch.* 707). See also the Indian case *Bansidhar* v. *Tata Power Co.*, (1925) 27 *Bom. L. R. p.* 330, where it was also laid down that the expression " directors, their agents and friends " included both business and social friends and was not restricted to only those personally influenced by directors. Again as per Romer, J., in *Lynde* v. *Anglo-Italian Hemp Stitching and Spinning Co.*, (1896) 1 *Ch.* 178) " to make a company liable for misrepresentations made inducing the contract to take shares from it, the shareholder must bring his case within one or other of the following heads :—(1) Where the misrepresentations are made by directors, or other general agents of the company entitled to act, and acting on its behalf, as for example by a prospectus issued by the authority or sanction of the directors of a company inviting subscriptions; (2) where the misrepresentations are made by a special agent of the company while acting within the scope of his authority, as for example by an agent, specially authorised to obtain on behalf of the company subscriptions for shares. This head, of course, includes the case of a person constituted agent by a subsequent adoption of his acts; (3) where the company can be held affected before the contract is complete, with the knowledge that it is induced by misrepresentation; as for example when the directors on allotting shares, know in fact that the application for them has been induced by misrepresentation even though made without any authority; (4) where the contract is made on the basis of certain representations, whether the particulars of those representations were known to the company or not, and it turns out that some of these representations were material and untrue, as for example if the directors of a company know when allotting that an application for shares is based on the statements contained in the prospectus was issued without the authority, of even before the company was formed and even if its contents are not known to the directors. In *Bansidhar*

v. *Tata Power Co.*, (1925) 27 *Bom. L. R.* 330, about which a reference has already been made, the directors stated in their prospectus that a certain number of shares were taken up by the "directors, agents and their friends" and the balance was offered to the public. B, who had applied for shares relying on this because of this statement, objected on the ground of misrepresentation because the shares were merely reserved and the reservees distributed them among their friends and thus the statement was alleged to be untrue. The lower Court held that the words "friends" included both social and business friends, but that it cannot mean friends of their business friends and thus the statement was untrue. The Appeal Court did not agree with this and held that the promoters had substantially "reserved" the number given in the prospectus and that though the reservees were arranging for others to pay and take them up it was substantially correct to state that they were reserved for the friends of the directors and agents. Omission of material facts in some cases amounts to misrepresentation. But the omission of such facts should be such as would make the prospectus misleading (*Aaron's Reef* v. *Twiss*, (1896) *A. C.* 273). The damages in this connection will be assessed on the basis of differences between the actual value of shares on the date of allotment, *i.e.*. the value which the said shares would have fetched if the particulars stated in the prospectus had proved to be accurate and the amount actually paid up in (*Peek* v. *Derry*, (1888) 37 *Ch. D.* 541).

However, it may be that where a shareholder misrepresented does not come for his remedy in time, he may lose his right to rescind by an implied ratification. The other point is that the shareholder so wishing to rescind must come for his remedy before winding up because on winding up the rights of creditors intervene (*Oakes* v. *Turquand*, (1867) *L. R.* 2 *H. L.* 325). In one case where a shareholder was suing for rescission of the shares the Court prevented the directors from enforcing a

forfeiture of these shares meanwhile pending the hearing (*Lamb* v. *Sambas Rubber Co.*, (1908) 1 *Ch.* 845). When a prospectus refers to a report and the facts stated in these reports are not accurate, the directors and the issuers of the prospectus must take the consequence (*In Reese River Silver Mining Co.*, (*Smith's Case*), (1867) *L. R.* 2 *Ch. Appl.* 604 *at p.* 611). In another case where the persons issuing the prospectus merely referred to a report as to a mine and made it clear that that report told what they knew, but they proposed to send out someone in order to test the said report, they were held not to be guaranteeing the truth of this report (*In re. British Burma Land Company,* (1867) 56 *L. R.* 815). In this connection it should be noted that the company's rights against the promoters are greater than against the vendors who are strangers. This is on principle that the promoter being a trustee for the company is in duty bound to make a full and fair disclosure of all material facts within his knowledge to the would-be shareholders. He has no right to deal with the company as a stranger. He is thus accountable to the company for any secret profits made by him (*Erlanger* v. *New Sombrero Phosphate Co.*, (1879) 3 *A. C.* 1218; *Lydney and Wigpool Co.* v. *Bird* (1886) 33 *Ch. D.* 985). We have already seen elsewhere that when a vendor who is also a promoter sells the property to the company without getting same adopted by an independent board is running a risk of the company rescinding the contract and restoring the property, or retaining it and paying the purchase money at the reduced price at which the vendor himself purchased same (*Bank of London* v. *Tyrrell,* (1862) 10 *H. L. C.* 26; *Bentinck* v. *Fenn,* (1888) 12 *A. C.* 652). This rule of course applies to a promoter who bought property immediately with a view to sell same away but as shown in *Bentinck* v. *Fenn* above, a person is not necessarily a promoter for the simple reason that at the time he acquired the property he contemplated on some future date to sell same to a company which he expected to form.

SHAREHOLDER'S CASE FOR DAMAGES

It may be added that one shareholder cannot bring a representative action in connection with misrepresentation on behalf of himself and all other members defrauded (*Hallowes* v. *Fernie,* (1867) 3 *Ch. Ap.* 471). Where a number of shareholders join as plaintiffs in one action on the ground that they had subscribed on the faith of the same prospectus, each of them must prove separately that he was induced to take shares by the untrue statements (*Arnison* v. *Smith,* (1889) 41 *Ch. D.* 337). It may be noted that sub-section 3 of this section 100 gives a right of indemnity to a person whose name is wrongly included in a prospectus against the directors who are responsible for the issue and preparation of the prospectus as well as all persons who authorised the issue of the same. Sub-section 4 goes further and gives a director or a person named as a director or to one who has agreed to become a director, or who has authorised the issue of the prospectus and becomes liable to make any payment under this section to recover contribution from the other directors as in cases of contract, from any other persons, who if sued separately would have been liable to make the same payment unless of course the person who became so liable was and that other person was not guilty of fraudulent misrepresentation. The right to contribution survives against the estate of a deceased director (*Shephard* v. *Bray,* (1906) 2 *Ch.* 235, (1907) 2 *Ch.* 571).

It may be added that under the Presidency Towns Insolvency Act of 1909 (S. 46) this claim of shareholders for damagee cannot be put in in the insolvency of the director if the same was not liquidated and judgment obtained before the person was adjudicated an insolvent. (*See Section* 34 *Provincial Insolvency Act,* 1920). The shareholder thus can present his action within six years, in this case from the date when the right to sue accrues, under Article 120 in the First Schedule of the Indian

Limitation Act of 1908 except where there has been fraud or fraudulent concealment in which case the limitation will not begin to run until the fraud is discovered (*S.* 18, *Indian Limitation Act,* 1908). One peculiarity may be remembered in this connection and that is that a subscriber to a memorandum cannot get relief in connection with misrepresentation or fraud for the simple reason that the company could not have adopted the misrepresentation before he took his shares (*Lord Lurgan's Case,* (1902) 1 *Ch.* 707). In this case two points were made; one was that the shareholder could not make such a claim for damages for the simple reason that (1) the Company before it came into existence could not appoint an agent and was therefore not liable for the acts of the promoters and (2) that by signing the memorandum the shareholder on the registration of the company became bound not only as between himself and the company but also as between himself and the other persons who should become members. One other case is where one of the directors with the knowledge of other directors obtained subscriptions. The company was held responsible for misrepresentation made by them (*Hilo Manufacturing Co.* v. *Williamson,* (1911) 28 *T. L. R.* 164). Here in this case the further point of law which is of general application applies, namely, that if the shareholder does not come forward to enforce his right immediately after having the knowledge of misrepresentation he cannot afterwards exercise his right to avoid the contract (*Clough* v. *London & North Western Railway Co.,* (1872) *L. R.* 7 *Ex.* 26). From this it follows that if after realising his position after misrepresentation the shareholder were to commit some act which gives an inference that he has connived at it he cannot come up for an action for misrepresentation. As we have already seen these acts may be either trying to sell shares (*Ex Parte Briggs,* (1866) 1 *Eq.* 483), or attending at meetings (*Sharpley* v. *Louth and East Coast Railway,* (1876) 2 *Ch. D.* 663, or signing proxies, paying calls, or accepting

dividends (*Scholey* v. *Central Railway of Venezuela*, (1868) 9 *Eq*. 266 *Note*). The principle here is that the shareholder is not allowed to wait and see whether the speculation turns out to be a favourable one, and then according to the result retain the benefit or repudiate the loss (*Downes* v. *Ship*, (1868) *L. R.* 3 *H. L.* 343). The relief of recission can be claimed even after the shares have been forfeited for non-payment of calls (*Houldsworth* v. *City of Glasgow Bank*, (1880) 5 *A. C.* 317). The Court in cases where the forfeiture is not complete may restrain forfeiture till the case is disposed off (*Lamb* v. *Sambas Rubber Co.*, (1908) 1 *Ch.* 845; *Jones* v. *Pacaya Rubber Co.*, (1911) 1 *K. B.* 455). In one other case it was held doubtful whether a delay of a fortnight in repudiating the shares was in the opinion of the learned Judge justified, especially in case of a going concern (*Scottish Petroleum Co.*, (1883) 23 *Ch. D.* 413). Delay with a view to investigate may be necessary and that may be allowed (*Central Railway Co. of Venezuela* v. *Kisch*, (1867) *L. R.* 2 *H. L.* 99). Here also though a delay of two months was allowed, it was emphasised that the party must come with the utmost diligence in a case like this.

The Directors' Liabilities for Statements in the Prospectus

Generally speaking, with regard to non-compliance or contravention of any of the requirements of the prospectus, it will not attach liability on the directors or other persons responsible for the prospectus if they can prove that as regards any matter not disclosed, the director concerned was not cognizant thereof or that non-compliance or contravention arose from an honest mistake of fact on his part or that *the non-compliance or contravention was in respect of matters which in the opinion of the Court were immaterial or was otherwise such as ought in opinion of the Court having regard to all the circumstances of the case reasonably to be excused*. However,

according to the Amending Act of 1936 Sec. 97(2) *every person who is knowingly responsible for the issue of such prospectus would be liable* besides his civil liability *to a fine not exceeding Rs. 50 for every day* from the date of the issue of the prospectus until a copy complying with the requirements of Sec. 93 is filed. Section 100 further lays down that where a prospectus invites the person to subscribe for shares, or debentures of a company, every person who has authorised the naming of himself as a director, or who is a director of the company, or who has authorised the issue of the prospectus, shall be liable to pay compensation to all persons who subscribe for any shares or debentures on the faith of the prospectus, for all loss or damage they may have sustained by reason of any misleading or untrue statement therein, or in any report or memorandum appearing on the face thereof, or by reference incorporated therein or issued therewith. In order to escape liability the person so sued should prove either of the following (S. 100) :—

(*a*) With respect to every misleading or untrue statement not purporting to be made on the authority of an expert or a public official document or statement, that he had reasonable ground to believe and did up to the time of the allotment of the shares or debentures as the case may be believe that the statement fairly represented the facts or was true.

(*b*) With respect to every misleading or untrue statement purporting to be a statement by or contained in what purports to be, a copy of or extract from a report or valuation of an expert that it fairly represented the statement or was a correct and fair copy of or extract from the report or valuation; provided that the director, person named as director, promoter or person who authorised the issue of the prospectus, shall be liable to pay compensation as aforesaid if it is proved that he had no reasonable ground to believe that the person making the statement, report or valuation was competent to make it; and

(*c*) With respect to every misleading or untrue statement purporting to be a statement made by

an official person or contained in what purports to be a copy of or extract from a public official document that it was a correct and fair representation of the statement or copy of or extract from the document;

or unless it is proved :—

(*i*) that having consented to become a director of the company he withdrew his consent before the issue of the prospectus and that it was issued without his authority or consent; or

(*ii*) that the prosepectus was issued without his knowledge or consent and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent; or

(*iii*) that, after the issue of the prospectus and before allotment thereunder, he on becoming aware of any misleading or untrue statement therein, withdrew his consent thereto, and gave reasonable public notice of the withdrawal and of the reason therefor.

Thus the section affords a special remedy to those who are induced by misrepresentation to subscribe for shares or debentures of a company against directors, promoters and other persons, besides action against the company itself as we have dealt with in the preceding paragraphs. This special remedy is a more effective remedy than the action of deceit because, there, in order to succeed the person has to prove that the statement was made by the party sought to be charged fraudulently, *i.e.*, knowing it to be false or recklessly, or not believing them to be true (*Derry* v. *Peek*, (1889) 14 *A. C.* 337). In this case it was decided by the House of Lords that the directors were not liable for misstatement in the prospectus in the absence of fraud and therefore according to Lord Justice Cozens-Hardy this section was enacted with a view to get rid of the above decision (*McConnell* v. *Wright*, (1903) 1 *Ch.* 546). The old remedy and rights of the shareholder remains in tact in this section, but it gives a new and more effective remedy to persons who subscribe for shares on the faith of the prospectus and were misled by misstatement therein. In other words when there is a fraud the remedy of the shareholder is

always there under the ordinary law, whereas in the absence of fraud, in case of misstatement, or misrepresentation, the remedy for damages is now given by this section. Of course those who subscribe for shares relying on the prospectus and get an allotment of the said shares from the company can take advantage of this section and not those who purchased the shares from outsider, *i.e.*, on the market and not from the company (*Ross* v. *Estates Investment Company*, (1868) 3 *Ch. App.* 682; *Henderson* v. *Lacon*, 5 *Eq.* 258). It should be noted that there is no remedy under this section and it does not apply where no prospectus has been issued, or where an application has been made before the issue of the prospectus. The section does not apply to bankers, brokers, accountants, engineers, valuers, etc., who have merely agreed to their names being used in connection with the publication of the prospectus, but the directors whose names appear on the prospectus are liable and other persons are liable only if they are proved to have authorised the issue of the prospectus. The remedy is lost to the shareholder if by any of his actions, after he became aware of the misstatement in the prospectus, he shows that he has accepted the shares, or has waived his rights by some acts such as selling, or trying to sell, the shares or signing proxies, or attending meetings, or accepting dividends (*Ex Parte Briggs*, (1866) 1 *Eq.* 483; *Sharpley* v. *South & East Coast Ry.*, (1876) 2 *Ch. D.* 663; *Scholey* v. *Central Ry. of Venezuela*, (1868) 9, *Eq.* 266 *Note*). The compensation and its measure would under this section be the actual loss suffered in consequence of the untrue statements. Where there is no value for the shares, then the entire amount paid for them will be recoverable (*Arnison* v. *Smith*, (1889) 41 *Ch. D.* 348). But where there is some real value for the shares, then the measure of damages will be the difference between the sum paid for them and that sum which would have been a fair price under the real circumstances of the company at the time of allotment (*McConnell* v. *Wright*,

(1903) 1 *Ch. D.* 546). Both in case of an action for deceit and in an action for rescission the omission of material facts will amount to a misrepresentation (*Central Railway Co. of Venezuela* v. *Kisch*, (1867) *L. R.* 2 *H. L.* 99; *Peek* v. *Gurney*, (1874) *L. R.* 6 *H. L.* 377). Of course, misstatement must be of an existing fact and an exaggeration would not necessarily come under this section because it has been laid down that the general commendation of his wares by a trader is not a false statement even though highly coloured and an anticipation of future result is not a statement of fact (*Bentley* v. *Black*, (1893) 9 *T. L. R.* 580). Under the ordinary rule of law the misstatement of law, unless it be a foreign law, is not a misstatement of fact, and no action for misrepresentation can lie as we have already seen on that ground. The one great point to remember here is that in connection with these cases the principle '*actio personalis moritur cum persona*,' that is, personal action dies with the person, applies. Though this is subject to this that to the extent of the loss which results to the aggrieved shareholders' estate or direct profit to that of the directors, the action survives and the executors of the deceived shareholders can commence or continue an action for that (*Twycross* v. *Grant, No.* 2, (1872) 2 *C. P. D.* 469); but on the other hand if the person who dies is a director or promoter who is charged, his executor cannot be sued in an action of deceit (*Peek* v. *Gurney*, (1874) *L. R.* 6 *H. L.* 377), but where a complete judgment has been obtained before his death, the decree can be executed against the estate of the deceased promoter or director.

Form of Action for Misrepresentation in the Prospectus

In an action for misrepresentation in a prospectus, if the company happens to be solvent, it is wise to proceed against the company alone, because in such a case it is not necessary to show that the statements were known to be untrue or that the company had no reasonable grounds for believing as in the case of an action

against the directors personally. In case of insolvent companies also, where the directors and promoters have to be sued, it is wise to make the company a party so that discoveries of the company's documents may be obtained. It is also advisable to make the promoter a party when he has taken a substantial part in the promotion so that documents in his possession may also be discovered and inspected.

Suit by a Single Shareholder or Member of the Company

In this connection it is important to note that the general rule is that the proper party to bring an action for the wrongs done to the company is the company itself, which applies to actions to make good losses sustained by the company by reason of fraudulent acts of one or more directors (*Foss* v. *Harbottle*, (1843) 2 *Hare* 461; *Gray* v. *Lewis*, (1873) 8 *Ch.* 1050; *Russcll* v. *Wakefield Waterworks Co.*, (1875) 20 *Eq. at p.* 474; *Burland* v. *Earle*, (1902) *A. C.* 83; *Dominion Cotton Mills* v. *Amyot*, (1912) *A. C.* 546). This was laid down on the cardinal principle applicable to companies that *primâ facie* the majority of the members are entitled to exercise the company's powers and operations. In cases where a single shareholder or member were to bring such a suit, the Court would naturally refer the matter to the general meeting of the company and in case the general meeting did not approve of it, the suit would be dismissed and costs would fall on the shareholder who brought the suit. If, however, the action was approved by the general meeting, the action will go on in the name of the company.

The only exceptions made in this connection are :—

(1) Where the act complained of is *ultra vires* the company, or is illegal (*Hope* v. *International Financial Society*, (1877) 4 *Ch. D.* 327; *Clinch* v. *Financial Corporation*, (1868) 4 *Ch.* 117; *Simpson* v. *Westminster Palace Hotel Co.*, (1860) 8, *H. L. Cas.* 712 : if the shareholder

has participated in the *ultra vires* act he will not be allowed to bring an action for restitution but he can obtain an injunction against a repetition of such act (*Towers* v. *African Tug Co.,* (1904) 1 *Ch.* 558; *Moseley* v. *Koffyfontein Mines Limited,* (1911) 1 *Ch.* 73); or

(2) Where he wants to restrain an act which constitutes an infringement of his individual rights such as his being prevented from voting at a general meeting; or being wrongfully excluded from the board of directors (*Pender* v. *Lushington,* (1877) 6 *Ch. D.* 70; *Pulbrook* v. *Richmond Consolidated Co.,* (1878) 9 *Ch. D.* 610); or

(3) Where there has been a fraud on the minority (*Alexander* v. *Automatic Telephone Company,* (1900) 2 *Ch.* 56; *Vadilal* v. *Maneckla1,* (1925) 49 *Bom.* 291; *Mason* v. *Harris,* (1879) 11 *Ch. D.* 97; or when the act done, though regular, is oppressive and unfair to the minority (*Const* v. *Harris,* (1824) *Turn and Ryan* 496; *Cook* v. *Deeks,* (1916) 1 *Ap. Cas.* 554; *Menier* v. *Hooper's Telegraph Co.,* (1874) 9 *Ch.* 350). It may noted that if in these cases the company cannot justify any of these acts, the Court here interferes to protect the minority. Here one or more shareholders may bring an action but the company must be made a defendant (*Atwool* v. *Merryweather,* (1868) 5 *Eq.* 464); or

(4) Where it is absolutely necessary to waive the rule as otherwise there may be a denial of justice (*Pender* v. *Lushington,* (1877) 6 *Ch. D.* 70). Say in a case where the majority are doing wrong act which does not fall under *ultra vires* or illegal act; or

(5) In case of winding up under S. 235 a contributory, or, creditor, or liquidator may apply to the Court *within three years from the date of the first appointment of a liquidator* to examine into the conduct of the promoter, director, manager, liquidator or officer with a view to compel him to repay or restore the money or property, or any part thereof, with interest at the rate fixed by the Court, also to contribute such compensation in respect of misapplication, retainer, misfeasance or breach of trust as the Courts think just.

In all other cases, the Courts have refused to interfere in case of suit, filed by a single shareholder on behalf of himself and other shareholders.

Suits by a Company

On the other hand the following actions must be brought by the company in its own name :—

(1) Actions brought to recover property belonging to the company or corporation, or redress of wrong done to the company, or to enforce the corporation rights (*Burland* v. *Earle,* (1902) *A. C.* 83; *Clarkson* v. *Davies,* (1923) *A. C.* 100). (The action in the name of the company can be brought only on sanction from the company in general meeting or by the board of directors). Here it should be noted that the action should commence in the name of the company in the capacity of a plaintiff through the majority of shareholders or in some cases of urgency a minority may commence action in the name of the company and thereafter obtain the company's sanction by the requisite resolution (*Pender* v.

Lushington, (1877) 6 *Ch. D.* 70; *La Campagnie de Mayville* v. *Whitley,* (1896) 1 *Ch.* 788, *Imperial Hydropathic Hotel Co.* v. *Hampson,* (1882) 23 *Ch. D.* 1). Here however if the majority's sanction cannot be obtained, the company's name as plaintiff will be struck off and the solicitor who uses the company's name or any co-plaintiff instructing the company may have to pay the cost notwithstanding the fact that the action has been discontinued (*Silber Light Co.* v. *Silber,* (1878) 12 *Ch. D.* 717; *Newbeggin Gas Co.* v. *Armstrong,* (1880) 13 *Ch.* 310; *Gold Reefs of Western Australia* v. *Dawson,* (1897) 1 *Ch.* 115; *Marshall's Valvegear* v. *Manning Wardle,* (1909) 1 *Ch.* 267).

(2) In such rare cases as where justice cannot be done otherwise than by bringing the suit in the name of the corporation (*In observations of Sir G. Jessel, M.R., on p.* 482 *in Russell* v. *Wakefield Waterworks Co.,* (1875) 20 *Eq. Cases* 474; *Atwood* v. *Merryweather,* (1868) 5 *Eq. Cases* 464. *See Note observations and judgment of Pagewood, V. C. on p.* 468).

Director's Right to Contribution

The director or other person who has paid damages for losses arising on an action of misrepresentation, or fraud, or misstatement in a prospectus, has a right to contribution from co-directors, or co-promoters, or others, who might have been made liable in the first instance. The original case on this point was *Shepheard* v. *Bray,* (1906) 2 *Ch.* 235 where *Warrington, J.,* held that the contribution extended to damages paid to a shareholder who threatened or actually brought action and which included reasonable sums paid in compromise, as well as costs between party and party of successful shareholders, plus

interest on the amounts paid as from the date of payment. Section 100 (4) of the Indian Companies Act 1913 however, in spite of the fact that this is a tort and tort feasers are not entitled to contribution, lays down that:—

"Every person who, by reason of his being a director or named as a director, or as having agreed to become a director, or of his having authorised the issue of the prospectus, becomes liable to make any payment under this section, may recover contribution, as in cases of contract, from any other person who, if sued separately, would have been liable to make the same payment, unless the person who has become so liable was, and that other person was not, guilty of fraudulent misrepresentation."

This sub-section establishes an exception to the general rule of tort, but is subject to the limitation that no such suit for contribution lies if the person who has been guilty of fraudulent misrepresentation and has been made liable cannot require contribution from the one by whom the misrepresentation was made innocently. The heirs of the deceased director are not liable to contribution unless they are benefited by the act of the director complained of (*Geipel* v. *Peach,* (1917) 2 *Ch.* 108).

CHAPTER IV.

Memorandum of Association

General Observations

Every joint stock company, under the Indian Companies Act, 1913, must have a memorandum of association duly subscribed, on the registration of which the foundation of the company is based. It is thus said that the memorandum of association of a joint stock company is its charter, and as such the most important document in connection with the company concerned. It is therefore superfluous to state that great care should be taken in the drafting of this most important document. The registration of this memorandum of association as well as the articles bind the company as well as its members to the same extent as if they had signed the said document. The Companies Act has laid down conditions which are fundamental to the formation of the companies and the memorandum of association contains them; these conditions being alike for the benefit of the creditors and the outside public as for the shareholders (*Guinness* v. *Land Corporation of Ireland,* (1883) 22 *Ch. D.* 349). The articles of association with which we shall deal in a subsequent chapter, are on the other hand the bye-laws, rules and regulations of the company which define the rights, privileges and duties of the company, of the persons managing the company and of its members. Thus it is said that the memorandum is subordinate to the Indian Companies Act of 1913 and that the articles are subordinate to the memorandum as well as the Act. This means that there should be nothing in the memorandum which violates or departs from the law laid down by the Act, whereas the articles should be so framed that they are strictly within the purview of the memorandum as

well as the Act. In other words, the articles cannot alter or modify the memorandum or the Sections of the Act. A memorandum of association is not a contract with third party even if there is a clause incorporating such a contract in the memorandum (*Ramkrishna Potdar* v. *The Sholapur S. and W. Co., Ltd.*, (1934) *Bom. L. R.* 907). Section 5 of the Indian Companies Act of 1913 lays down that—

Any seven or more persons (or, where the company to be formed will be a private company, any two or more persons) associated for any lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company, with or without limited liability (that is to say), either—

(*i*) a company having the liability of its members limited by the memorandum to the amount, if any unpaid on the shares respectively held by them (in this Act termed a company limited by shares); or

(*ii*) a company having the liability of its members limited by the memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company, in the event of its being wound up (in this Act termed a company limited by guarantee); or

(*iii*) a company not having any limit on the liability of its members (in this Act termed an unlimited company).

It will thus be seen that a company may be formed either as (1) a limited company the liability of whose members is limited to the unpaid amount on the shares; or (2) a company limited by guarantee, where the members' liability is limited by the memorandum to such amount as they undertake to contribute to the assets of the company in the event of their being wound up; or (3) a company not having any limit on the liability of the members, that is, an unlimited company.

In case of the company whose liability is limited by shares, the memorandum shall state the following :—

(*i*) the name of the company with "limited" as the last word in its name;

(*ii*) the province in which the registered office of the company is to be situate;
(*iii*) the objects of the company;
(*iv*) that the liability of the members is limited;
(*v*) the amount of share capital with which the company proposes to be registered, and the division thereof into shares of a fixed amount. (Sec. 6).

In case of a company limited by guarantee, the Memorandum is required to state the following :—

(*i*) the name of the company with "limited" as the last word in its name;
(*ii*) the province in which the registered office of the company is to be situate;
(*iii*) the objects of the company;
(*iv*) that the liability of the members is limited;
(*v*) that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member, or within one year afterwards for payment of the debts and liabilities of the company contracted before he ceases to be a member, and of the costs, charges and expenses of winding up, and for adjustment of the rights of the contributories among themselves, such amount as may be required, not exceeding a specified amount.

If the company has a share capital—

(*i*) the memorandum shall also state the amount of share capital with which the company proposes to be registered and the division thereof into shares of a fixed amount;
(*ii*) no subscriber of the memorandum shall take less than one share;
(*iii*) each subscriber shall write opposite to his name the number of shares he takes.

In the case of an unlimited company the memorandum shall state the following :—

(*i*) the name of the company;
(*ii*) the province in which the registered office of the company is to be situate;
(*iii*) the objects of the company;

If the company has a share capital—

(*i*) no subscriber of the memorandum shall take less than one share;

(*ii*) each subscriber shall write opposite to his name the number of shares he takes.

This memorandum is required to be signed as we have already noticed, in case of a private company by at least two members, whereas in case of a public company by at least seven. The signature of each of the members so subscribing to the memorandum has also to be attested by a witness.

Signing of Memorandum

This memorandum is required to be signed, as we have already seen, by at least seven members in case of a public company and two in case of a private company. This subscription or signature should be placed at the foot of the memorandum with the address and occupation of each signatory and the number of shares agreed to be taken by each opposite to each signature. These signatories have to sign in the presence of at least one witness, who, besides attesting the signatures, must write his occupation and address. There is no objection to one witness attesting all the signatures provided he is not a subscriber to the memorandum himself (*Seal* v. *Claridge*, (1881) 7 *Q. B. D.* 516). If the attestation of a memorandum of association which has been registered turns out to be irregular, it does not render same void (*Chhotalal* v. *Dalsukhram*, (1892) 17 *Bom.* 472). As we have already seen the memorandum must be stamped according to the requirements of the Indian Stamp Act of 1899, plus the increase, if any, laid down by the local stamp act of each province. The signatories must be competent to enter into a contract irrespective of the fact whether they are British subjects or foreigners (*Reuss (Princess)* v. *Bos*, (1871) *L. R.* 5 *H. L.* 176). The signatory may be an agent signing on behalf of the principal if he is properly authorised (*Whitley Partners, Ltd.*, (1886) 32 *Ch. D.* 337). A married or unmarried woman can be a subscriber. After her signature the unmarried woman may describe herself by her occupation, if any, or failing that as a spinster. A

married woman should state after her name, as "wife of Mr. X" or a simple statement such as "married woman" will serve the purpose. A minor cannot be a subscriber owing to his incapacity to contract and his contracts for business purposes or for purposes other than necessaries are void (*Mohori Bibee* v. *Dharamdoss,* (1903) *L. R.* 30 *I. A.* 114). In an English case an infant was held to be a person and thus a competent signatory (*Laxon & Co.*, (1892) 3 *Ch.* 555). This is however not good law in India (*Moosa Gulam Ariff* v. *Ebrahim Gulam Ariff,* (1912) *L. R.* 39 *I. A.* 237; (1913) 40 *Cal.* 1). A firm or partnership cannot subscribe to the memorandum because a partnership is not a legal person and all individual partners must sign. A bankrupt and an alien can subscribe (*Princess of Reuss* v. *Bos,* (1871) *L. R.* 5 *H. L.* 176, *In re. General Co. &c.,* (1870) 5 *Ch. App.* 363). A corporation or a joint stock company can subscribe and be a member or a shareholder if its constitution permit it to hold shares (*Bath's case,* (1878) 8 *Ch. D.* 334; *Barned's Banking Co*, *Ex-parte Contract Corporation,* (1867) 3 *Ch.* 105).

As to the subscription or signature on the memorandum the same must be either by the member himself, or his duly authorised agent and after the signature, the number or shares which the subscriber agrees to take up is stated. The usual practice is to state one share though the subscriber may ultimately intend to take a much larger number. It makes no difference whether the persons subscribing the memorandum are independent persons or represent the same interest. In one case *viz.,* (*Salomon* v. *Salomon,* (1897) *A. C.* 22) it was held by Lord Herschell that even if the shareholders were mere dummies, or nominees of one man, so long as they undertook to hold the shares, they could subscribe. As we have seen elsewhere the subscribers to the memorandum of association become members of the company from the date of the registration of the memorandum (Sec. 30(1)). A subscriber cannot after registration of the company repudiate his subscription on the ground that he was made to sign

under misrepresentation because at the time he subscribed the company was not in existence and thus it could be said that the company was a party to the misrepresentation or fraud (*Metal Constituents Ltd.,—Lord Lurgan's case*, (1902) 1 *Ch.* 707). In fact it becomes the duty of the directors to put the subscriber on the register for the shares he has subscribed forthwith on registration of the memorandum (*Evan's case*, (1867) 2 *Ch.* 427). Here the subscriber must take the shares from the company and it will not do if he obtains them from a promoter or any other person (*Migotti's case*, (1867) 4 *Eq.* 238). The subscriber to the Memorandum can pay for his shares either in cash or by transfering the property (*Baglan Hall Colliery*, (1870) 5 *Ch.* 346); but the shares can only be paid for in kind where there is previous agreement to do so, or there is a mention to that effect in the memorandum or articles of association (*Fothergill's case*, (1873) 8 *Ch.* 270). Again the subscriber is bound only to take that class of shares which he has agreed to purchase by subscription and an agreement to substitute that class for some other class of shares will not be binding on him (*Duke's case*, (1876) 1 *Ch. D.* 620). It has been however held that this case was so held because to hold otherwise would have been a great hardship (*Ashbury* v. *Watson*, (1885) 30 *Ch. D.* 376).

The position of the subscribers to the memorandum of a company according to Section 30 is that they shall be deemed to have agreed to become members of the company, and on its registration shall be entered as members in its register of members. Subscribers to the memorandum are members not merely persons who have contracted to purchase shares. A deceased member is not a "past member" within the meaning of Sec. 156 (*Off. Liquidator, U. P. Oil Mills Co.* v. *Jamna Prasad and others*, (1933) 55 *All.* 417). We have already seen that a subscriber to the memorandum cannot after registration repudiate his share on the ground of misrepresentation. (See misrepresentation in prospectus).

CONTENTS OF THE MEMORANDUM

Having thus far dealt with general points applying to the memorandum of association, we shall now deal with each of the clauses which make up the memorandum, and their peculiarities, together with the law applying to same.

The Name of the Company

The first point to be noted in connection with the name is that it should not be similar to, or identical with that of any existing company, or so nearly resembling that name as to be calculated to deceive except when the company in existence is in the course of being dissolved and signifies its consent in such manner as the registrar requires (S. 11). The registrar will not register a company with a name identical with that of an existing company, and even where the name is so similar as to be calculated to deceive, the same result will follow.

Again where a company bears a name which is likely to lead others to believe that the company which is applying to be registered is carrying on the business of some existing firm or company, the registration shall be refused, as the registrar has a discretion in the matter. The Court would not interfere by *mandamus* unless either the registrar had not in fact exercised any discretion in the particular case, or had exercised it upon some wrong principle of law, or had been influenced by extraneous considerations which he ought not to have taken into account (*Rex* v. *Registrar of Companies,* (1912) 3 *K. B.* 23). In case a new company secures registration through some inadvertance, with a name or business which is likely to be mixed up with that of an existing company, the latter can by an injunction restrain, the new company from using that name or from being registered with such a name (*Huntley & Palmer* v. *Reading Biscuit Company,* (1892) 9 *T. L. R.* 462). In the above case *Huntley* succeeded in getting an injunction restraining the *Reading Biscuit Company Limited* from using the word "*Reading*"

in connection with their name, on the ground that it was likely to mislead the public in believing that the *Reading Company* was doing the business if *Messrs. Huntley & Palmer,* inasmuch as the word "*Reading*" was being prominently used for years in connection with the biscuits of *Messrs. Huntley & Palmer.* In another leading case on the point, namely that of *Madame Tussaud and Sons* v. *Tussaud,* (1890) 44 *Ch. D.* 678), *Mr. Louis Tussaud* was prevented from registering the company for the purpose of carrying on a wax-works exhibition business under his own name, namely, that of *Louis Tussaud Limited,* mainly on the ground that even though this was the personal name of a prominent member of the company, it resembled that of another existing company carrying on similar business (see also *Jays Ltd.* v. *Jacobi,* (1933) 1 *Ch.* 411; *Turton* v. *Turton,* (1889) 42 *Ch. D.* 198. A person with a fraudulent objective cannot use even his own name (*Croft* v. *Day,* (1843) 7 *Beav.* 84). The sound as well as the spelling of the name has also to be considered here (*Ouvah Ceylone Estates* v. *Uva Ceylone Rubber Estates Ltd.,* (1910) 27 *Rep. Pat. Cas.* 753). This rule applies irrespective of the fact that there was no fraudulent intention on the part of the promoters of the proposed company. All that is required is that the Court should be satisfied that the name in which the company seeks to register itself is "likely to mislead" or is "calculated to deceive" irrespective of the intention of the promoters (*National Bank of India Ltd.* v. *National Bank of Indore,* (1922) 24 *Bom. L. R.* 1181). In the course of the judgment in *Tussaud's* case referred to above, *Stirling, J.,* observed that even though *Tussaud* was the name of the promoter of the company who was to be its servant, that gave the company no right to adopt that name, as it happened to be similar to that of the old established company of great reputation in the same line of business, because the use of such a name was bound to mislead customers, who in this case were made up of travellers from foreign countries, in mixing up the two wax-works exhibition and believing the new company

to be the same as the old one, deprive the old company of its profits. In the opinion of His Lordship, the fact whether the company had in its service a person with the name of *Tussaud,* or not, made no difference, because *Louis Tussaud,* of the new company having no right of goodwill in the old company could not confer that right to the new company. All that can possibly be conferred was the right of a statement to the effect that the business of the company was under his (*Louis Tussaud's*) management. But he could not say " I will become your servant or manager, modeller or souvenir and shall carry on the business—which is not to be mine, but yours . . . . . . under my name " (See also *North Cheshire and Manchester Brewery Co.* v. *Manchester Brewery Co.,* (1899) *A. C.* 83). A company is not entitled to carry on business under a name which is likely to deceive the public as to its identity (*Sturtevant Engineering Co., Ltd.* v. *Sturtevant Mills Co. of U. S. A., Ltd.,* (1936) 3 *All. E. R.* 137). A person who has never done business in his own name cannot register a company in his name if it is likely to cause confusion or mislead the public in thinking that the company he floats has some connection with an existing company (*Harrods Ltd.* v. *R. Harrod Ltd.,* (1924) 4 *T. L. R.* 195; *Fine Cotton Spinners' Association* v. *Harwood Cash & Co.,* (1907) 2 *Ch.* 184). This besides applying to English companies also applies to Foreign companies or traders, whose goods are imported into the British Empire, as in the case of *La Societe Anonyme des Anciens Etablissments Panhard et Levassor* v. *Panhard Levassor Motor Company, Limited,* (1901) 2 *Ch.* 513. . . . . where the plaintiffs, who were a French Company carrying on business in Paris as motor car manufacturers in succession to the former firm of *Panhard et Levassor* and were using the word "*Panhard*" in connection with motors of their manufacture, objected to the use of the word *Panhard* in the name of the defendant company on the ground that the principal object of the defendant was to wrongfully and fraudulently injure the

plaintiffs' business by passing off their goods as those of the plaintiffs' manufacture, and succeeded even though they (the plaintiffs) had no agencies in England but had a market for their goods there.

It should, however, be added that mere similarity of name will not in itself be considered a sufficient ground for objection, provided the use of such a name does not injure the business of the existing company. This would generally be the case where the business proposed to be carried on by the new company whose name has some similarity with that of the old company, is quite distinct from that of the objecting company, and where there is no danger of deception or misunderstanding (*Dunlop Pneumatic Tyre Company, Limited* v. *Dunlop Motor Co.*, (1907) A. Cas. 430). It may be further added that it is not necessary to prove any fraudulent intention on the part of those using a similar name. All that is wanted is that the name is likely to mislead considering all circumstances (*Singer Machine* v. *Wilson*, (1877) 3 *A. C.* 376; *Merchant Bank Company of London* v. *Merchants' Joint Stock Bank of London*, (1878) 9 *Ch. D.* 560; *Standard Bank of South Africa* v. *Standard Bank*, (1909) 25 *T. L. R.* 420). There have been cases however where the Courts have refused injunctions on the ground that the name adopted being merely descriptive of the character of the business of the companies concerned, they could not interfere (*London and Provincial Law Society* v. *London and Provincial Joint Stock Life Assurance Company*, (1847) 17 *L. J. Ch. D.* 37; *Colonial Life Assurance Co.* v. *Home and Colonial Assurance Company*, (1864) 33 *Beav.* 548; *British Vacuum Cleaner Company* v. *New Vacuum Cleaner Company*, (1907) 2 *Ch.* 312). Generally speaking the two important factors to be taken in view in this connection are the nature of the name and the type of the business. If the nature of the business is the same and name is similar to that of an existing company, the objection would naturally arise as that factor is one which is likely to mislead the public (*Aerators Co.* v. *Tollitt*, (1902) 2 *Ch.*

319; *Lloyds Bank* v. *Lloyds Investment Co.,* (1912) 28 *T L. R.* 379; *Waring & Gillow* v. *Gillow and Gillow,* (1916) 32 *T. L. R.* 389). It may be that an ordinary English word may acquire a secondary meaning as to denote only the goods sold, or manufactured by the plaintiff, but of course that fact will have to be proved and will be a difficult fact to prove (*Reddaway* v. *Banhan,* (1896) *A. C.* 199; *Aerators Co.* v. *Tollitt,* (1902) 2 *Ch.* 319). Similar would be the position where the name selected is descriptive of the place where the business is carried on (*Colonial Life Assurance* v. *Home and Colonial Assurance Co.,* (1864) 33 *L. J. Ch.* 741). In one case where an insurance company was carrying on business under a name in which the word "guardian" was used as the first word it was restrained from carrying on business in the same street with another company using the same word in its name (*Guardian Fire and Life Assurance* v. *Guardian & General Insurance,* (1881) 50 *L. J. Ch.* 253) and another company with a word "accident" in its name was similarly restrained from using that name though a registered company (*Accident Insurance Company Limited* v. *Accident Disease and General Insurance,* (1884) 54 *L. J. Ch.* 104). Where the name misleads in the belief that an existing company has been absorbed by the newly formed company that will be a ground for injunction (*Manchester Brewery Co.* v. *North Cheshire and Manchester Brewery Co.,* (1899) *A. C.* 83). A descriptive word or title cannot be appropriated in its name by a company in order to obtain a monopoly of same (*Aerators' Co.* v. *Tollitt,* (1902) 2 *Ch.* 319). Any person in fact whether a company, or individual, can by showing that he suffered special damage, restrain other person from registering a company under a name calculated to deceive (*Tussaud* v. *Tussaud,* (1890) 44 *Ch. D.* 678; *Hendriks* v. *Montague,* (1881) 17 *Ch. D.* 638). However, if a company through inadvertence, or otherwise, is registered by a name identical with that by which a company in existence is previously registered, or so nearly

resembling it as to be calculated to deceive, the first named company may with the sanction of the registrar change its name. (Sec. 11(2)). In this case the registrar usually requires a resolution of the company authenticated by the secretary or some officer of the company.

Statutory Prohibition

In this connection S. 11(3) lays down that "*Except with the previous consent in writing of the Governor-General in Council, no company shall be registered by a same which :—*

(*a*) *contains any of the following words, namely, 'Crown,' 'Emperor,' 'Empire,' 'Empress,' 'Federal,' 'Imperial,' 'King,' 'Queen,' 'Royal,' 'State,' 'Reserve Bank,' 'Bank of Bengal,' 'Bank of Madras,' 'Bank of Bombay,' or any word which suggests or is calculated to suggest the patronage of His Majesty or of any member of the Royal Family or any connection with His Majesty's Government or any department thereof;* or

(*b*) *contains the word 'Municipal' or 'Chartered' or any word which suggests or is calculated to suggest connection with any municipality or other local authority or with any society or body incorporated by Royal Charter;*

Provided that nothing in this sub-section shall apply to companies registered before the commencement of this Act."

The other requisite is that in case the company is a limited company, the name shall contain the word "Limited" as the last word. The other requirement with regard to the name is that the same shall be painted or affixed in a prominent place and in letters easily legible outside the office or place or places of business of the company, and further that, in every circular, letter, or document, advertisement and other publications issued officially by the company, the said name shall appear. The name should also be engraved in legible characters on the company's seal. This writing of the name has to be done in English characters, and where the company's registered office is situate in a place beyond the local

limits of the ordinary original civil jurisdiction of the High Court, it should also be painted or printed, in the characters of one of the Vernacular languages used in the place. The failure to observe these requirements make every officer who knowingly authorises or permits the same to a fine not exceeding Rs. 50 for every day during which the default continues (Sections 73, 74). The same rule applies to all bills of exchange, hundis, promissory notes, endorsements, cheques, or orders for money or goods, issued by the company and signed by itself or one of its officers.

The Registered Office

Under the second clause of the memorandum of association, all that is required is that a statement as to the province in which the registered office of the company is situated may be mentioned. No doubt it is compulsory under Section 72 for a company to have a registered office *as from the date on which it begins to carry on business, or as from the twenty-eighth day after the date of its incorporation whichever is the earlier* at which all communications, and notices may be addressed and a notice in writing of the situation of the registered office and of any change therein shall be *given within* 28 *days after the date of the incorporation of the company or of the change as the case may be to* the registrar who shall record same. The inclusion in the annual return of a company of the statement as to the address of its registered office shall not be taken to satisfy the obligation imposed by the section. In case the company carries on business without complying with these requirements, it shall be liable to a fine not exceeding Rs. 50 for each day during which it carries on its business. The filing fee for such notices is Rs. 3 for each document. The transfer or change in the place of the registered office of the company from one province to another can only be made according to section 12 by a special resolution and after obtaining confirmation from the Court on the same footing as in case of the

alteration of the objects clause of the memorandum of association which we shall deal with later on in detail. However, if the company does not happen to have a registered office, service of notices and petitions may be effected even at an unregistered office (*British and Foreign Gas Generating Apparatus Co.*, (1865) 13 *W. R.* 649; 12 *L. T.* 368; *Fortune Copper Mining Co.*, (1871) 10 *Eq.* 390). Normally of course where there is a registered office, it is the proper place where all notices, writs of summons and other processes must be served; Order 29, rule 2 of the Code of Civil Procedure, (1908) regulates service of processes on all joint stock companies, under the Indian Companies Act, 1913 and all previous Acts. The same Order also lays down that if the summons cannot be served at the place where the company carries on business because it has no registered office, it may be served at any office where its business is done or on its secretary, or director, or other principal officer. In case of foreign companies incorporated outside British India having a place of business in British India, they are required to file with the registrar the particulars required under Section 277 and the processes or notices required to be served on them are under the same section sufficiently served if addressed to any person whose name has been filed as one authorised to accept such service on behalf of the company or left at or sent by post at the address which has been filed under the section. With regard to the exact meaning of the words "carrying on business" it is thought that the same will include issue of prospectus, receiving applications for and allotting shares and other preliminary matters.

The Purpose of a Registered Office

It will thus be seen that the main purpose sought to be achieved by the Indian Companies Act, 1913 in requiring a company to have its registered office is :—

(1) To provide definitely a place at which notices and other documents may be served (Section 148 which

clearly says that a document may be served at a company by leaving it at, or sending it by post to, the registered office of the company) thus service at any other place is declared to be bad. (*Hope Mills* v. *Vithaldas*, (1910) 12 *Bom. L. R.* 730). Of course where a company has no registered office, summonses and notices may be served at a place where it carries on business or on its secretary or any director or other principal officer [Order 29 rule 2 Code of Civil Procedure, (1908)].

(2) To definitely fix a place where the register of members must be kept and should be open to inspection during business hours as provided for by the Act. Also the same object is achieved in connection with the register of mortgages and charges required to be kept under Section 117 and to the right of inspection of same under Section 124.

(3) The Indian Companies Act also requires under Sec. 136 that every banking or insurance company, or a deposit provident or benefit society, before it commences business and also on the first Monday in February and first Monday in August every year during which it carries on business, shall make a statement in the form prescribed, (marked G in the third schedule) or as near thereto as circumstances will admit. The registered office is the place where this statement *together with a copy of the last audited balance sheet laid before the members of the company* is to be displayed. The description of the registered office must be specific as " 80 Esplanade Road, Bombay " and not such as " 80 Esplanade Road, Bombay or any other place in Bombay to which the office may be removed from time to time." A company which is registered in England may be an alien enemy if those who *de facto* control its affairs are alien enemies whether authorised or otherwise, and in determining this point the number of alien enemy shareholders is material (*Daimler Co.* v. *Continental Tyre Co.*, (1916) 2 *A. C.* 307). If a company is simply carrying on business in an enemy country though registered in England, it will not necessarily

be an enemy alien company (*Re. Hilckes, Ex-parte Muhesa Rubber Plantations,* (1917) 1 *K. B.* 48).

Notice of Change in the Situation

When there is a change in the situation of the registered office the form of notice would be as follows :—

INDIAN COMPANIES ACT 1913.

Notice of Change in the Situation of the Registered Office of the Bombay Trading Co., Ltd. Pursuant to Sec. 72(2).

To

The Registrar of Companies,

Bombay.

The Bombay Trading Company Limited hereby gives you notice in accordance with Indian Companies Act, 1913 that the registered office of the company is now situated at :—

80, Esplanade Road, Bombay.

J. Fernandiz,
Secretary.

Bombay,
15th June 1937.

The Objects Clause

The objects clause is the most important of all the clauses in the memorandum and has therefore to be drafted with considerable care. The scope of a company's operations is indicated principally by this clause, and as we shall see later, the alterations, if found afterwards necessary, through the irregular and careless drafting in this regard, are most difficult as well as expensive. Besides, the Act has provided for a very limited scope for these alterations. It is therefore best to state all the branches of the business which the company is formed to carry on with all clearness and in detail. Words such as " to do such other business as may be deemed incidental or conducive to the attainment of the above objects, or any

of them", would only mean objects similar to those expressly provided for in the clause. Attempts have been made to make the "objects clause" all embracing by the use of some such words as "to do any other business which the company may, from time to time, determine". Such a form is objectionable, and generally speaking, the registrar will refuse to register the company with such wide and undefined objects. The next point to remember is that what the objects clause is expected to embrace are the objects and the powers by which these objects are to be carried out. The objects for which the company is formed should be legal, *i.e.*, they should not include anything which is opposed to the general law, or to the requirements of the Companies Act itself. The principle that the objects stated in this clause in the memorandum cannot be departed from materially, was laid down so far back as 1860, in the famous case of *Simpson* v. *Westminster Palace Hotel Co.*, (1860) 8 *H. L. C.* 712. Here, though it was held that a company which was, according to the objects clause of its memorandum, principally formed for the purpose of carrying on the business of a hotel, and for that purpose was empowered to purchase lands, give leases, erect buildings, etc., was within its rights to let out a portion of its premises temporarily. The dictum laid down there was, that the funds of a joint stock company established for the purpose of one undertaking, cannot be applied to another, in spite of the fact that the same was sanctioned by all the directors and by a large majority of the shareholders. The Lord Chancellor, Lord Campbell, said in this connection that "the funds of a joint stock company established for one undertaking cannot be applied to another. If an attempt to do so was made, such an act would be *ultra vires*, and although sanctioned by all the directors and by a large majority of shareholders, a single shareholder has a right to go to a Court of Equity which will interpose on his behalf by injunction. A railway company cannot apply its funds to make a line of railway different from that described in the Act by which the com-

pany was constituted; companies established for granting of fire and life insurance policies cannot engage in marine insurance; a company established to work railway and to carry on the trade of a carrier on a line from one town of England to another, cannot add to it the trade of a steam packet company, and no company can ever abandon the business for which it was established and undertake another."

Besides these, there are powers which a joint stock company cannot exercise under any circumstances, and therefore they must not be included in the objects clause,

(1) A railway company, which wanted to improve the navigation of a river which was necessary for its prosperity, was prevented from doing so on the ground that the application of funds to promote a Bill in Parliament for an object so different from that for which the corporation was formed was *ultra vires* (*Munt* v. *Shrewsbury Railway Company,* (1850) 13 *Beav.* 1).

(2) On the same ground as taken in the above case a railway company, which proposed to subscribe to the Imperial Institute, was prevented from doing so (*Tomkinson* v. *S. G. Railway Company,* 56 *L. T.* 830); and another railway company proposing to work coal mines for selling coal on profit was prevented (*Attorney-General* v. *G. N. Railway Company,* (1860) *I. Dr. and Sm.* 154). Also where a company's funds were attempted to be applied for the purpose of paying the costs of its directors in a libel suit, it was declared *ultra vires,* because the company was not at all concerned with the libel (*Studdert* v. *Grosvenor,* (1886) 33 *Ch. D.* 528)

On the other hand the following have been held to be *intra vires* :—

Where a company formed to work a patent, bought the same (*Leifchild's case,* (1865) 1 *Eq.* 231); where a company enjoying powers of lending money lent same to a servant of the company (*Rainford* v. *James Keith,* (1905) 2 *Ch.* 147) where a trading company created a mortgage in

order to secure a debt (*Patent File Company,* (1870) 6 *Ch.* 83).

Rules of Construction Applying to Memorandum

It may be added here that there is no particular rule of construction or interpretation of documents which would apply to the memorandum and articles of a company and it has been held that they should be construed in a manner so that a just and no other construction would arise, they are not expected to be construed liberally or strictly or rigorously (*London Financial Association* v. *Kelk,* (1884) 26 *Ch. D.* 107). The only thing that could be done is that where the memorandum happens to be ambiguous or silent, the articles of association may be referred for the purpose of explaining the memorandum in respect of a matter which need not appear in the latter, but of course, with regard to anything which the Act requires to be stated in a memorandum, the memorandum must be the only document that could be looked at (*Re. Southern Brazil Rio Ry. Co.,* (1905) 2 *Ch.* 78; *Guinness* v. *Land Corporation of Ireland,* (1882) 22 *Ch. D.* 349). Generally speaking where wide and general powers are given, in addition to specific powers, the wide powers will only be read as ancillary to the specific powers and not treated as independent objects (*German Date Coffee Co.,* (1882) 20 *Ch. D.* 169). Of course in case of doubt the memorandum must be read as a whole with a view to see whether the latter clauses are really intended to include powers beyond those contained in the earlier clauses (*Butler* v. *Northern Territories Mines of Australia,* (1907) 96 *L. T.* 41). In some cases the memorandum clearly lays down that each paragraph is to be read separately and without limitation by reference to other clauses. Here effect must be given to this provision (*Cotman* v. *Brougham,* (1918) *App. Cases* 514). Express powers given cannot be ignored for the simple reason that they differ widely from the principal objects of the company. There is also a practice of adding provisions which are really not required by the Act to be

stated in the memorandum such as an agreement with the managing agent or a similar paragraph. In such cases it was previously held that such paragraphs in the memorandum would be unalterable (*Ashbury* v. *Watson,* (1885) 30 *Ch. D.* 376). This was of course subject to the rule that where the memorandum itself gives the power of altering such provisions that can be done (*Welsbach Incandescent Gas Co.,* (1904) 1 *Ch.* 87). This law is now altered by the proviso added to S. 10 by the Amending Act of 1936 to the effect that *any provision in the memorandum relating to the appointment of a manager or managing agent and other matters of a like nature incidental or subsidiary to the main objects of the company shall not be deemed to be " conditions "* of the memorandum as laid down in S. 10, which cannot be altered except as provided for by the Act. Of course it cannot be argued that everything which is not included or expressed in so many words in the memorandum must be *ultra vires.* Everything which could be fairly regarded as incidental or consequential to the objects which are specified is not *ultra vires* unless expressly prohibited (*Attorney-General* v. *The Great Eastern Ry. Co.,* (1880) 5 *App. Case* 473). Thus ancillary clauses have been treated on several occasions as extending the powers of the company (*Re. Baglan Hall Colliery Co.,* (1870) 5 *Ch.* 346).

Powers Implied according to Main Objects and ultra vires Acts

In case of joint stock companies besides the expressed language of the objects the powers are implied according to the nature of the objects as laid down by the memorandum of association. Thus a trading or banking company is always implied to have the power to borrow (*General Auction Estate Co.* v. *Smith,* (1891) 3 *Ch.* 432; *Bank of Australasia* v. *Breillat,* (1847) 6 *Moo. P. C.* 152). A Building Society has no implied powers to borrow (*Blackburn Benefit Building Society* v. *Cunliffe Brooks,* (1882) 22 *Ch. D.* 61). In case of trading companies the

power to borrow naturally implies the power to mortgage its property (*Re. Patent File Co.,* (1870) *L. R.* 6 *Ch.* 83). Virtually speaking all companies have implied powers to compromise *bona fide* disputes (*Bath's case,* (1878) 8 *Ch. D.* 334).

A Hotel company was allowed to let off a part of its premises which it did not require for the purposes of its hotel business and similarly a colliery was allowed to sell surplus land it did not require (*Simpson* v. *Westminster Palace Hotel Co.,* (1860) 8 *H. L. C.* 712; *Kingsbury Colliery & Moor's Contract,* (1907) 2 *Ch.* 259). An Insurance Company is permitted to pay *ex gratis* more than its legal liability to pay (*Taunton* v. *Royal Insurrance Company,* (1864) 2 *H. & M.* 135). A trading company or an association not for profit is permitted to grant pension to retiring officers or servants or to the widow of a deceased manager but these powers would be *ultra vires* after liquidation (*Normandy* v. *Indcoope & Co.,* (1908) 1 *Ch.* 84; *Henderson* v. *Bank of Australia,* (1888) 40 *Ch. D.* 170; *Hutton* v. *The West Cork Ry.,* (1883) 23 *Ch. D.* 654). It has however been held that it is *ultra vires* for a company to subscribe for purposes other than authorised for the memorandum as *e.g.,* to strike funds (*Warburton* v. *Hudderfield Industrial Society,* (1892) 1 *Q. B.* 213). The spending of the funds of a railway company for promoting a bill in Parliament to obtain powers for improving the navigation of a river was held *ultra vires* though it was relevant to the prosperity of the company (*Munt* v. *Shrewsbury Rail Co.,* (1850) 13 *Beav.* 1). It was also held *prima facie ultra vires* for a company working a railway to take up a coal mine and work it with a view to deal in coal for profit (*Attorney-General* v. *The Great Northern Rail Co.,* (1860) 1 *Dr. & Sm.* 154). It is also *ultra vires* a company without special powers in its Memorandum to take over the undertaking of another company or to enter into a partnership for amalgamation arrangement (*Ernest* v. *Nicolls,* (1857) 6 *H. L. C.* 401; *British Nation Life Association,* (1878) 8 *Ch. D.* 704). Of course

a company cannot apply its funds in purchasing its own shares (*Trevor* v. *Whitworth,* (1887) 12 *App. Cases* **409**). It is also *ultra vires* a company under the Companies Act to make present of bonus shares (*Re. Eddystone Marine Insurance Co.,* (1893) 3 *Ch.* 9). The result when an act is *ultra vires* a company is that it is not binding on the company and contracts which are *ultra vires* the company are not enforceable against it. We shall further see that where the acts are *intra vires* the company, but *ultra vires* the directors, the company can ratify the contract if it so desires and thus make it binding on it as well as the third party; or it can reject that, whereby it will not be bound by the acts of its directors, but the directors themselves may be personally liable to the third party. This point will be dealt with in connection with liabilities of the directors.

Drafting of the Objects Clause

It may be mentioned that in connection with the drafting of the objects clause, it is advisable to be as specific as possible, *i.e.,* to state clearly and in so many express words all types of businesses which the company is likely to do and not to rely too much on the general words as these general words are likely to be treated as inoperative. It was at one time the practice to add such words as "and also such additional or extended objects as the company may from time to time determine." Such words have no legal effect and are unnecessarily misleading in the memorandum when inserted. The present-day practice is to insert in the memorandum elaborately both the objects and the powers of the company, which makes the objects clause no doubt lengthy. This practice has been commented upon adversely by Lord Wrenbury in a House of Lords Case, *viz., Cotman* v. *Brougham,* (1918) *A. C.* 514. But the practice has continued in spite of His Lordship's objections against them for practical reasons as laid down by Mr. Palmer in his famous book on "Company Precedents," *viz.,* that "It should be borne in mind

that the objects clause of a memorandum is intended to be read and understood and acted on not merely by lawyers, but by ordinary businessmen; and such men like to see the powers of the company expressed with fulness and in considerable detail instead of resting in implication." A similar practice has now grown in connection with the drafting of articles of association as we shall see in a later chapter, where not only the special powers given to the shareholders and directors are enumerated, but clauses are also added which define in detail the duties of all concerned in the internal management of the company irrespective of the fact that whether the same are added there or not they would apply automatically, being the well-established principles of company law, enunciated either by the statute or by well-known decisions. The dominating idea here is that the layman, who has to work a company, would be reminded as to what he has to do step by step in connection with the working and organization of the company.

The Form of the Objects Clause

The usual practice now is to state in the first one or two sub-clauses to clause three of the memorandum of Association the specific purpose for which the company is established, whereas the other sub-clauses are more or less stereotyped and are to be found in almost all memorandums of association. They reiterate or state various powers which the company is likely to exercise in the course of its career however remote the chances of such exercise may be. To illustrate this we give below a model illustration of the "objects clause" of a company formed to manufacture felt hats, caps, etc.

A SPECIMEN FORM OF OBJECTS CLAUSE TAKEN FROM ACTUAL PRACTICE AS A PRECEDENT

The objects for which the company is established are :—

(1) To manufacture, purchase, sell or otherwise deal in felt hats and caps, braids, ribbons, lace, embroideries, tapes,

wicks, putties, charpoy webbing, trace and belt webbing, cords, ropes, string, twine and textile fabrics of all kinds either directly or indirectly through the medium of agents.

(2) To carry on the business of drapers and furnishing and general warehousemen in all its branches.

(3) To carry on all or any of the businesses of silk mercers, silk weavers, cloth manufacturers, furriers, haberdashers, hosiers, manufacturers, importers, and wholesale and retail dealers of and in textile fabrics of all kinds, milliners, dress-makers, tailors, hatters, clothiers, outfitters, glovers, lace manufacturers, feather dressers, boot and shoe makers and manufacturers, and importers and wholesale and retail dealers of and in leather goods, household furniture, iron-mongery, turney, and other household fittings and utensils, ornaments, stationery, and fancy goods, and other articles and commodities of personal and household use and consumption, and generally of and in all manufactured goods, materials, provisions and produce.

(4) To carry on any other business (whether manufacturing or otherwise) which seem to the Company capable of being conveniently carried on in connection with the above or calculated directly or indirectly to enhance the value of or render more profitable any of the Company's property.

(5) To purchase or by other means acquire any freehold, leasehold, or other property for any estate or interest whatever and any rights, privileges, or easements over or in respect of any property, and any real or personal property or rights whatsoever which may be necessary for, or may be conveniently used with, or may enhance the value of any other property of the Company.

(6) To purchase or by other means acquire and protect, prolong, and renew, whether in British India or elsewhere, any patents, patent rights, brevets d'invention, licences, protections, and concessions which may appear likely to be advantageous or useful to the Company, and to use and turn to account and to manufacture under or grant licences or privileges in respect of the same, and to expend money in experimenting upon and testing and in improving or seeking to improve any patents, inventions, or rights which the Company may acquire or propose to acquire.

(7) To acquire and undertake the whole or any part of the business, goodwill, and assets of any person, firm or

company carrying on or proposing to carry on any of the businesses which this company is authorised to carry on, and as part of the consideration for such acquisition to undertake all or any of the liabilities of such person, firm or company, or enter into any arrangement for sharing profits, or for co-operation, or for limiting competition, or for mutual assistance with any such person, firm or company, and to give or accept, by way of consideration for any of the acts or things aforesaid, or property acquired, any shares, debentures, debenture stock, or securities that may be agreed upon, and to hold and retain, or sell, mortgage, and deal with any shares, debentures, debenture stock, or securities so received.

(8) To improve, manage, cultivate, develop, exchange, let on lease or otherwise, mortgage, sell, dispose of, turn to account, grant rights and privileges in respect of, or otherwise deal with all or any part of the property and rights of the company.

(9) To search for, get, win, work, raise, make marketable and use, sell, and dispose of coal, oil, iron, clay, precious and other metals, minerals and other substances or products on, within, or under any property of the Company, and to grant prospecting and mining and other licences, rights or privileges, for such purposes.

(10) To invest and deal with the moneys for the Company not immediately required upon such securities and in such manner as may from time to time be determined.

(11) To lend and advance money or give credit to such persons and on such terms as may seem expedient, and in particular to customers and others having dealings with the company, and to give guarantees or become security for any such persons.

(12) To borrow or raise money in such manner as the company shall think fit, and in particular by the issue of debentures or debenture stock (perpetual or otherwise) and to secure the re-payment of any money borrowed, raised, or owing by mortgage charge, or lien upon the whole or any part of the company's property or assets (whether present or future), including its uncalled capital, and also by a similar mortgage, charge or lien to secure and guarantee the performance by the company of any obligation or liability it may undertake.

(13) To draw, make, accept, endorse, discount, execute, and issue promissory notes, bills of exchange, hundies, bills

of lading, warrants, debentures, and other negotiable or transferable instruments.

(14) To apply for, promote, and obtain any Act, Provisional Order or Licence of the Government of India or Local Government or other authority for enabling the company to carry any of its objects into effect, or for effecting any modification of the company's constitution, or for any other purpose which may seem expedient, and to oppose any proceedings or applications which may seem calculated directly or indirectly to prejudice the company's interests.

(15) To enter into any arrangements with any Governments or authorities (supreme, municipal, local, or otherwise), or any corporations, companies, or persons that may seem conducive to the company's objects or any of them, and to obtain from any such Government authority, corporation, company, or person, any charters, contracts, decrees, rights, privileges, and concessions which the company may think desirable and to carry out, exercise, and comply with any such charters, contracts, decrees, rights, privileges and concessions.

(16) To subscribe for, take, purchase, or otherwise acquire and hold shares or other interest in or securities of any other company having objects altogether or in part similar to those of this company or carrying on any business capable of being conducted so as directly or indirectly to benefit this company.

(17) To act as agents or brokers and as trustees for any person, firm, or company, and to undertake and perform sub-contracts and also to act in any of the businesses of the company through or by means of agents, brokers, sub-contractors, or others.

(18) To remunerate any person, firm or company rendering services to this company, whether by cash payment or by the allotment to him or them of Shares or securities of the company credited as paid up in full or in part, or otherwise.

(19) To pay all or any expenses incurred in connection with the formation, promotion, and incorporation of the company, or to contract with any person, firm, or brokers and others for underwriting, placing, selling, or guaranteeing the subscription of any shares, debentures, debenture stock, or securities of this company.

(20) To support and subscribe to any charitable or public object, and any institution, society or club which may

be for the benefit of the company or its employees, or may be connected with any town or place where the company carried on business to give pensions, gratuities, or charitable aid to any person or persons who may have served the company, or to the wives, children, or other relatives of such persons; to make payments towards insurance; and to form and contribute to provident and benefit funds for the benefit of any persons employed by the company.

(21) To produce the company to be registered or recognised in any colony or dependency and in any Foreign country or place.

(22) To promote any other company for the purpose of acquiring all or any of the property or undertaking any of the liabilities of this company, or of undertaking any business or operations which may appear likely to assist or benefit this company or to enhance the value of any property or business of this company, and to place or guarantee the placing of, underwrite, subscribe for or otherwise acquire all or any part of the shares or securities of any such company as aforesaid.

(23) To sell or otherwise dispose of the whole or any part of the undertaking of the company, either together or in portions, for such consideration as the company may think fit, and in particular for shares, debentures, debenture stock, or securities of any company purchasing the same.

(24) To distribute among the members of the company in kind any property of the company, and in particular any shares, debentures, debenture stock, or securities of other companies belonging to this company or of which this company may have the power of disposing.

(25) To do all such other things as may be deemed incidental or conducive to the attainment of the above objects or any of them.

The Vol. II Appendix A gives a collection of specimen forms of the objects clauses of different types of businesses, to which reference may be made when the secretary or the lawyer wants a precedent to guide him in drafting such a clause. The precedents are mostly collected from the registered memorandums of association of Indian joint stock companies.

Declaration of Liability of Members

The next clause of the memorandum of association states whether the liability of the members of the company is to be limited or unlimited. In case it is to be limited, it should be made clear, whether, it is to be limited by guarantee or limited to the face value of the shares issued in case of companies whose capital is divided into so many shares. If the liability is to be limited, the statement should run as follows :—" The liability of the *members* is limited." It is not at all correct to say that " The liability of the *company* is limited." When a company is formed with a capital divided into shares, and the liability of members is limited to the face value of the shares they have taken up, or agreed to take up, it means that in case of liquidation of the company, the utmost that a member could be called upon to pay is the amount which remains unpaid on the nominal value of the shares he holds. This liability not only attaches to the present holders, *i.e.*, the shareholders who were shareholders at the time the company went into liquidation, but it also attaches to every member who had transferred his share or shares, within one year from the date of liquidation of the company, in case the person to whom he had transferred his shares, within this period of one year fails to pay the " calls " made by the liquidator on his unpaid amount of capital and that total amount contributed by the members is insufficient to pay the debts of the company. Of course, these must be such debts as were incurred during the term of his membership.

Besides this, it is provided by Sec. 70, that in a limited company though the liability of members may be limited, the liability of directors or of any of them may, if so provided by the memorandum, be unlimited. In this case, a person who proposes any person for election or appointment to the office of director with unlimited liability has to include in his proposition, a statement to the effect that the liability of the person holding that office will be unlimited and the promoters or officers of the company shall

before such a person accepts the office or acts, gives notice to such proposed director in writing informing him of the nature of his liability. Failure to take this precaution will make proposer as well as promotor or officers concerned liable to a fine, not exceeding Rs. 1,000 and also to damages which the person so selected as director may sustain as a result of this omission. When a director with unlimited liability retires from office, his liability ceases with respect to the debts incurred during the term of his office at the expiration of one year from the time of his retirement. It may be added here that in case of limited companies, the limited liability of the members is lost where their number falls below seven in case of public companies and below two in case of private companies. In such a case the remedy of any surviving member is to immediately apply for an order for compulsory liquidation in self-protection.

CAPITAL OF THE COMPANY

Classes of Capital and Shares

The capital of a joint stock company may be described under the following headings or terms :—

(1) Nominal capital, also called registered or authorised capital.

(2) Subscribed capital.

(3) Paid-up capital.

(4) Called-up capital.

(1) Nominal, or registered capital, is the full amount of capital with which the company is registered, and which it proposes shall be the highest limit of its capital to be subscribed. It happens in practice that, either the whole of the nominal capital is subscribed, and sometimes paid up, or as in other cases, a portion of its nominal capital may have been issued or applied for and allotted, whereas, the rest may not at all have been applied for.

(2) Issued, or subscribed capital, is the amount of capital which has been applied for, and allotted, and

which the members who have applied for are bound to take up and pay for. This also includes the capital issued to the vendors as fully or partly paid, and also, that issued fully paid to the founders as remuneration for their services.

(3) *Paid-up capital*, is that capital which is actually paid for, either in cash, or in some other consideration. It differs from the subscribed capital in so far as the capital subscribed may not have been called up in full, and the said called-up capital may not have been fully paid up by its members as we shall see in the illustration following.

(4) Called-up capital is that part of capital for which actual calls have been made by the directors.

To illustrate the above, supposing a company is registered with a capital of Rs. 1,00,000. The nominal capital of the company would be Rs. 1,00,000. Now, if the total amount of applications received for shares are, say, 80, each for one share of Rs. 1,000, and supposing that the whole amount applied for is allotted, the subscribed capital of the company would amount to Rs. 80,000. Now, supposing that the application money to be paid is Rs. 100, per share, the allotment money is another Rs. 100, and that the balance of Rs. 800, is to be paid in calls of Rs. 200 each, as the directors may choose to make them, and if the directors have made one calls of Rs. 200 the called-up capital in this instance, at the rate of Rs. 400, per each share, on 80 shares, would amount to Rs, 32,000. If, out of the called-up capital, holders of 10 shares have not paid their first call of Rs. 200, each, whereas, the rest have paid their application, allotment and call money, the paid-up capital of the company would amount to Rs. 30,000. The balance of Rs. 2,000 would appear on the balance-sheet under the heading of "calls in arrear."

The Capital Clause

This clause states the amount of the authorized capital with which the company is registered and its

division into share, distinguishing classes of shares, if any, such as preference shares, ordinary shares, deferred shares, etc. This authorized capital indicates the limit of capital which the company is permitted to issue, until, of course, it increases the capital by going through the formalities laid down by the act with which we shall deal later. The rights and privileges of each class of shareholders need not necessarily be stated in the memorandum as they can be conveniently referred to in the Articles. In case, the right and powers of each class of shareholders are stated in the memorandum, a power to alter or vary this right ought to be taken in the said document, in order to save the trouble and expense of altering the same at a later stage.

The wording in which the statement of the company's capital and its division generally appears is as follows :—

"The capital of the company is Rs. 1,00,000, divided into 100 shares of Rs. 1,000 each." Here it is not necessary that all the 1,000 shares should be issued or subscribed for, but the utmost limit here laid down is Rs. 1,00,000 beyond which the company cannot issue without altering the memorandum. This capital is quite distinct and separate from the amount raised through the issue of debentures, which though called in common parlance "loan capital" does not form part of the capital at all, but is money raised, or borrowed, which only trading companies have the implied power to do, and which every other class of companies can do, under powers specially taken in its memorandum.

In case where the shares are divided into different denominations carrying different rights and privileges, as to the payment of dividends or as to the return of capital on the winding up of the company, that may be stated either in this clause of the memorandum or in the articles of association of the company. It is not compulsory that the powers to issue different denominations of shares should be expressly taken in the memorandum of association,

as the company can at any time take these powers (*Andrews* v. *Gas Meter Company,* (1897) 1 *Ch. D.* 361; *Ashbury* v. *Watson,* (1885) 30 *Ch. D.* 376). Generally speaking, it is thought that it is wise to show on the face of the memorandum that it is the intention of the company that the powers of this type may be exercised. It should, however, be remembered that once the powers are stated in the memorandum they cannot subsequently be varied without the sanction of the Court unless the memorandum itself confers powers to alter such rights (*Underwood* v. *London Music Hall,* (1901) 2 *Ch. D.* 309). The usual practice is to state in the memorandum that these shares are to enjoy such powers as the articles of association may from time to time confer, in which case a free hand is left for the alteration of such powers by the usual alteration of the articles of association itself (*Collins* v. *Birmingham Breweries,* (1899) 15 *T. L. R.* 180). The best course to follow is to state that the company has the power to issue ordinary and preference shares and leave the rest to the articles.

Classes of Shares

Generally speaking, shares of a joint stock company are divided into different varieties such as the ordinary, preference, deferred and founders' shares. The preference share carries a preference as to the payment of dividends out of the profits of each year up to a fixed percentage, which preference may be made cumulative, *i.e.*, in case the profits of a particular, or a series of consecutive years, do not admit of a dividend being paid, such dividend gets accumulated to be paid during any subsequent year when the profits are large enough to admit of such a payment. In case a surplus is left after these payments, the ordinary shareholder is paid out of it his dividend for the current year up to the fixed or agreed percentage. The balance, if any, is divided either in full or in the proportion fixed by the articles among the holders of deferred or founders' shares.

Which Shares to Invest in

The answer to the question as to which form of security out of the three classes dealt with above, should attract investors, depends on the nature of the enterprise, as well as on the temperament of the investor concerned. Late Mr. Alfred Nixon, F.C.A., in his book on "Advanced Book-keeping" very aptly remarks that Mr. Cautious invests in preference shares, Mr. Speculative in deferred shares, and Mr. Medium in ordinary shares. We might complete the picture by adding that Mr. Wiseman invests in all in due proportion selecting the enterprise in each individual case with due care and proper judgment. In case of investors who are satisfied with a moderate return on their capital, as long as the same is steady and regular, the preference shares of a substantial company offer the best medium, the only other form of joint stock company investment which is considered more secure than that of preference shares, is that offered by debenture bonds of substantial companies, particularly those carrying a fixed charge on some valuable property of the company. Here the status of the investor is that of a secured creditor. The percentage of interest on such investments will be naturally lower compared to the dividend fixed on preference shares of a company of equal standing. Where the preference shares carry also preference as to the return of capital on liquidation, they are even more attractive to a cautious investor of the class we are considering though of course the debenture holder stands on a superior footing here also.

Preference Shares

These are shares, the dividends on which are preferred, *i.e.*, the agreement is that the holder is entitled to a fixed dividend out of the available profits made by the company during the year under review, before the holders of ordinary, or deferred shares, are paid anything. If the preference is what is known as "simple prefer-

ence," it gives the holder a right to claim a fixed percentage as dividend, out of the profits of each year, and therefore, if during any year, there are no profits available for dividend, the preference shareholders do not get any dividend during that year; nor can they claim the dividend not so paid out of the profits of any of the subsequent years. If, however, the preference is "cumulative," the shares carry the additional right under which dividends not paid during any year, owing to insufficiency of profits, accumulates to be paid during any subsequent year when the available profits are sufficient. The preference shares are usually non-cumulative and the clause giving such a power generally makes the same clear. Great care should be exercised in the drafting of the clause which describe this preference, and a bare statement to the effect that the preference shareholders are entitled to preferred dividends, at a specified rate per cent, will mean a cumulative right, whereas, if it is made clear that the preference is to attach to the profits of each year they shall be non-cumulative (*Staples* v. *Eastman Photographic Materials Co.*, (1896) 2 *Ch. D.* 303). The preference right, however, may not only attach to the payment of dividends out of the profits, but it may also attach to the return of the capital. In this case, in the event of liquidation, preference shareholders will be entitled to the return of their capital in full, after the ordinary creditors are paid, and before the ordinary as well as deferred shareholders get anything. This power should, of course, be expressly reserved either in the memorandum or in the articles. The holders of preference shares and debentures of a company shall have the same right to receive or inspect balance sheets of the company, reports of auditors, etc., as is possessed by the ordinary shareholders in a joint stock company.

The question frequently arises when new preference shares are desired to be issued whether this can be done by superseding the rights of the original preference-shareholders. An answer to this can only be given after

carefully noting the language of the clause in which the rights of the original shareholders is reserved, and ascertaining what is the exact nature of the bargain made with them. If it appears from the language that the intent is to issue further preference shares, with priority over the rights of the original shareholders is contemplated, the original preference shares, can be postponed (*James* v. *Buena Ventura Syndicate*, (1896) 1 *Ch.* 456; *Underwood* v. *London Music Hall*, (1901) 2 *Ch. D.* 309). When preference shareholders have participated as per their rights of preference either out of profits, or out of capital, they shall have no further right to participate in the assets of the company unless otherwise provided for in the articles (*National Telephone Co., Ltd.*, (1914) 1 *Ch.* 755). In this case, *viz.* that of the *National Telephone Co.*, *Sergeant, J.*, in the course of his judgment said that "Looking at the way in which *Swinfen Eady, J.*, dealt with the question of the rights of winding up, as being analogous to the similar rights to dividend while the company is a going concern, and looking to the canon of construction which was applied by the Court of Appeal in *Will* v. *United Lankat Plantations Co.*, (1912) 2 *Ch.* 571, it appears to me that the weight of authority is in favour of the view that either with regard to dividend or with regard to the rights in a winding up, the expressed gift or attachment of preferential rights to preference shares, on their creation, is *prima facie*, a definition of the whole of their rights in that respect, and negatives any further or other right to which but for the specified rights, they would have been entitled. In my opinion, therefore, this surplus is not divisible except among the deferred stock holders."

In one case, however, where the company's articles of association provided that dividends are to be paid out of "profits only" and further added "in the event of winding up of the company the holders of the preference shares shall be entitled to have the surplus assets applied first in paying off the capital paid up on the preference shares, secondly in paying off the arrears of preferential

dividend, if any, up to the commencement of the winding up and thereafter to participate rateably with the holders of other shares, in the residue, in any of such surplus assets which shall remain after paying off the capital paid up on such other shares," it was held that there were arrears of dividends although there never were any profits out of which the dividends could have been paid and that now that the winding up had commenced, the surplus assets were liable to meet not only the capital of the preference shares, but also the whole of the 10 per cent (as in this case provided) preference dividend (*In Re. Springbok Agricultural Estates, Ltd.*, (1920) 1 *Ch. D.* 563). It may be added that there is no objection to articles being so framed as not to give the preference shareholders any right of voting and in such case apart from some special provision in the articles preference shareholders, who have no right of voting, are not entitled to be summoned to general meetings (*In Re. Mackenzie & Co., Ltd.*, (1916) 2 *Ch. D.* 450).

Variation of Rights

In connection with the alteration of rights of preference shareholders Section 54 clearly gives this power in case of a company limited by shares. It lays down that such a company may by special resolution confirm by an order of the Court modify the conditions contained in its memorandum so as to reorganise its share capital where by consolidation of shares of different classes or by the division of its shares into shares of different classes it makes a proviso that no preference or special privilege attached to or belonging to any class of shares shall be interfered with except by resolution passed by a majority in number of shares of that class holding three-fourths of the share capital of that class, and that every such resolution shall bind all shareholders of the class. This order when made a certified copy has to be filed with the registrar within 21 days after the making of the order or within such extended time as the Court may allow. In

case the resolution is not filed it shall not take effect until that is done. In one case where only one person holding all the preference shares would formally consent to modification of the rights of preference shareholders was held to be equivalent to a resolution passed at a meeting of that class of shareholders (*Re. Foucar & Co., Ltd.*, (1913) 29 *T. L. R.* 350).

In this connection it may be noted that variation rights of any class of shareholders has been specifically provided for by section 66(*a*) of the Indian Companies Amendment Act of 1936 which of course includes those of preferential shareholders. *Here it is laid down that if in case of a company, the share capital of which is divided into different classes of shares, provision is made by the memorandum or articles for authorising variation of the rights attached to any class of shares in the company, subject to the consent of specified proportions of the holders of the issued shares of that class or the sanction of a resolution passed by a separate meeting of the holders of these shares, and in pursuance of the said provision the rights attached to any such class of shares are at any time varied, the holders of not less in the aggregate than ten per cent of the issued shares of that class who did not consent to or vote in favour of the resolution for variation may apply to the Court to have the said variation cancelled. Where any such application is made, the variation shall not have effect unless and until it is confirmed by the Court. An application for this purpose must be made within 14 days after the date on which the consent was given and the resolution was passed as the case may be. This application may be made on behalf of the shareholders entitled to make the application by such one or more other member as they may appoint in writing for the purpose. The Court after hearing the applicant and any other person who applies to the Court to be heard and who is interested in the application, may if it is satisfied having regard to all the circumstances of the case that the variation would unfairly prejudice the share-*

holders of the class represented by the applicant disallow the variation. If on the other hand the Court is not satisfied it would confirm the variation. The decision of the Court on any such application shall be final. The company must within 15 days after the service of any order may on any such application forward a copy of the said order to the registrar. In case of default in complying with this provision, the company and every officer who is knowingly and wilfully in default is liable to a fine not exceeding Rs. 50. The expression " variation " in this section includes " abrogation " and the expression " varied " shall be construed accordingly.

This section was first introduced in English Companies Act of 1929 on the recommendation of the Greene Commission of 1925-26 because in the opinion of the Commission the modification of rights clauses in articles sometimes operated so as to cause hardship. In the opinion of the Commission this was particularly the case where, for example, preference shareholders whose rights it was proposed to cut down, held ordinary shares, who would be benefited by the modification and who would use their votes as preference shareholders at the preference shareholders meeting to secure such benefit to themselves against the interest of the general body of preference shareholders. They thus recommended that the remedy lay in giving the Court in proper cases a power to review the resolution of a class meeting which in their opinion would be sufficient to prevent injustice without interfering with the beneficial operation of the modification clauses in the articles.

Apart from the articles or the memorandum or any special agreement the Court cannot in construing the terms on which the preference or other shares have been issued look into the prospectus (*Chicago and North West Granaries Co.,* (1898) 1 *Ch.* 263 : *Tewkesbury Gas Co.,* (1912) 1 *Ch.* 1). In case where the shares are issued as preference shares without the company having any power to do so or in case they are issued in an irregular manner the subscribers would be entitled to have their money

refunded and would be classed as the creditors of the company for same (*London and New York Investment Corporation*, (1895) 2 *Ch.* 860).

A Specimen Capital Clause, with different Classes of Shares

The following is a specimen clause selected from the memorandum of association of a prominent Indian company laying down the division and rights of different classes of shareholders :—

The capital of this company is Rs.........divided into........ ordinary shares of Rs.........each, ...preference shares of Rs.........each and.........deferred shares of Rs.........each. The rights and privileges of each of the aforesaid class of shares shall be as follows :—

(*a*) The preference shares, shall, subject as hereinafter provided, confer on the holders the right out of the profits of the company which it shall be determined to distribute in dividend to a fixed cumulative preferential dividend at the rate of 6 per cent. per annum on the capital for the time being paid thereon respectively, to be calculated from the first day of April 1933; and the right in a winding up, to payment of capital and arrears of dividend, whether declared or undeclared up to the commencement of the winding up, in priority to the ordinary and deferred shares, but shall not confer any further right to participate in profits or assets.

(*b*) Subject as aforesaid, the ordinary shares shall confer on the holders the right out of the profits of each year in which it shall be determined to distribute a dividend, to a non-cumulative dividend for such year at the rate of 8 per cent per annum on the capital for the time being paid-up or credited as paid-up thereon respectively, and shall rank as regards such dividend next after the said preference shares.

(*c*) Subject as aforesaid, the deferred shares shall confer on the holders the right out of the profits of each year in which it shall be determined to distribute a dividend, to a non-cumulative dividend for such year at the rate of 25 per cent per annum on the capital for the time being paid-up thereon respectively.

(*d*) Sub-clauses (*b*) and (*c*) of this clause shall be deemed to confer upon the holders of ordinary and deferred shares respectively the right to dividends at the rates respectively specified so far as profits are available for payment thereof; but shall not be

deemed to preclude such holders from receiving dividends at a lower rate if the profits shall be insufficient to pay dividends at the specified rates.

(*e*) Subject as aforesaid, any profits which it may at any time be determined to distribute amongst the members shall be divided by way of additional dividend, as to 50 per cent thereof between the holders of the ordinary shares, in proportion to the amounts paid-up or credited as paid-up thereon respectively, and as to the other 50 per cent thereof between the holders of the deferred shares, according to the number of deferred shares held by them respectively.

(*f*) The term profits used in this clause shall be deemed to consist of such monies as shall from time to time be declared by the directors to be available for distribution in dividends in terms of the articles of association of the company, and it is hereby expressly provided that the directors have power before recommending any dividend to set aside out of the profits of the company such sums as they may think proper to form a depreciation fund for repairing, improving and maintaining any of the property of the company a reserve fund to meet contingencies, a sinking fund to repay debentures or debenture stock or for special dividends or for equalising dividends, a provident or benefit fund or any special fund for any other purposes as the directors may, in their absolute discretion, think conducive to the interests of the company.

(*g*) Subject to the rights of the holders of the preference shares as aforesaid, any surplus assets in a winding up, after paying off the capital paid-up on the ordinary shares and the deferred shares rateably, shall be divided as to 40 per cent thereof between the holders of the ordinary shares in proportion to the ordinary shares held by them respectively, and as to the other 60 per cent thereof between the holders of the deferred shares in proportion to the deferred shares held by them respectively, and in each case according to the amounts paid-up, or credited as paid-up on such ordinary shares and deferred shares respectively at the commencement of the winding up.

(*h*) Any shares issued as fully paid pursuant to the agreements referred to in clause 3 of the accompanying articles of association shall, for the purposes of dividend, be treated as having been paid-up at the date of the registration of the company.

NOTE.—The special paragraph (*h*) above refers to the agreement made with managing agents, promoters for the allotment of fully paid shares for trouble taken information of the company as well as for property sold if any, or expenses incurred and paid on behalf of the company.

Frequently after stating the rights and privileges of various classes of shareholders, a further paragraph is added in the memorandum giving power to the company to alter these rights in accordance with the articles of association. That para. would run as follows :—

The rights hereby attached to the said preference shares may be modified or dealt with in accordance with article 14 of the accompanying articles of association, but not otherwise, and that article shall be deemed to be incorporated herein and have effect accordingly.

As to the companion clause in the articles of association referred to above as article 14 for the purpose of fitting in with the said clause in the memorandum, the following article headed "modification of rights" is to be found :—

Forms of Article for Modification of Preference Rights

Whenever the capital, by reason of the issue of preference shares or otherwise is divided into different classes of shares, all or any of the rights and privileges attached to each class may be modified or dealt with by agreement between the company and any person purporting to contract on behalf of that class, provided such agreement is confirmed by a special resolution passed at a separate general meeting of the holders of shares of that class; and all the provisions hereinafter contained as to general meetings shall *mutatis mutandis* apply to every such meeting, but so that the quorum thereof shall be members holding or representing by proxy two-thirds of the nominal amount of the issued shares of the class. This clause is not to derogate from any power the company would have if it were omitted.

Form of an Alternative Clause of same Article

The same clause appears in the articles of association of companies incorporated in England in the following form :—

If at any time the capital by reason of the issue of preference shares or otherwise is divided into different classes of shares, all or any of the rights and privileges attached to each class may be modified, commuted, affected or abrogated by agreement between the company and any person purporting to contract on behalf of that class, provided such agreement is (*a*) ratified in writing by the

holders of at least three-fourths of the nominal amount of the issued shares of that class, or is (*b*) confirmed by an extraordinary resolution passed at a separate general meeting of the holders of shares of that class, and all the provisions hereinafter contained as to general meetings shall *mutatis mutandis* apply to every such meeting, except that the quorum thereof shall be members holding or representing by proxy three-fourths of the nominal amount of the issued shares of that class. This clause is not by implication to derogate from the power of modification which the company would have if the clause were omitted.

Form of Article Preserving Rights of New as well as Present Issue

With a view to preserve the rights of the company to issue new preference or ordinary shares and at the same time to preserve the present rights and privileges of the old preferential shareholders in the original capital unaltered, or uninterfered with, a clause such as the following is also inserted in the memorandum :—

Upon any increase of capital any new shares may be issued with any preferential, qualified, deferred or special rights, privileges and conditions attached thereto, but so that none of the rights hereby attached to the preference shares in the original capital shall be altered or interfered with, otherwise than in accordance with the provisions of the last preceding clause hereof.

Where though the original issue is divided into shares of one single class, but power is desired to be reserved to issue preference shares in the future, the capital clause takes up the following form :—

The capital of the company shall consist of rupees fifteen lacs divided into 15,000 shares of Rs. 100 each with power to the company to increase or reduce the said capital with such rights and privileges as may be deemed necessary.

Preferential Rights Reserved in the Articles

When the rights of different classes are not defined or reserved by the memorandum of association, the capital clause of the memorandum only states the capital of the company and its division into respective classes more or less as follows :—

The capital of the company is Rs. 5,00,000 (Rupees Five Lacs) divided into 50,000 (fifty thousand) preference shares of Rs. 5 (five) each, and Rs. 50,000 (Fifty thousand) ordinary shares of Rs. 5 (five) each, capable of being increased for the time being or any portion thereof in accordance with the company's regulations and legislative provisions for the time being in force in that behalf.

The articles would then under the heading "Capital" deal with the rights of the various preference shareholders as follows :—

The capital of the company shall be rupees five lacs divided into fifty thousand preference shares of rupees five each and fifty thousand ordinary shares of rupees five each, capable of being increased as hereinafter provided and in accordance with the Regulations of the company and the Legislative provisions for the time being in force in that behalf.

The preference shares will entitle the holders thereof to a fixed preferential dividend of 8 per cent per annum on the amount paid-up and to 50 per cent of the balance of the net profits after the payment of 16 per cent dividend to the holders of the ordinary shares. The ordinary shares will entitle the holders thereof to a dividend of 16 per cent after the payment of 8 per cent fixed dividend on the preference shares and to 50 per cent of the balance of net profits after the dividends due on the preference and the ordinary shares have been paid.

The preference shares shall be entitled in a winding up to have the capital paid-up thereon to be paid off in priority to the ordinary shares, but shall not confer any further right to participate in profits or assets.

With reference to the question as to what are the rights of preference shareholders as to the surplus assets left in the hands of the liquidator after paying out all the liabilities of the company as well as all the paid-up capital to the shareholders, the latest case decided is that of *In Re. William Metcalfe & Sons, Ltd.*, (1933) 1 *Ch. D.* 142. The case was originally decided by Eve, J., and was confirmed by the Appeal Court. According to Eve, J., "surplus assets" signifies something different from the expression "Capital."

"Surplus assets are part and parcel of the property of the company not required for the discharge of its liabilities or for returning to the shareholders the capital they have paid-up; they are part of the joint stock or common fund which, at the date of the winding

up, represented the capital of the company, but they are no part of the repayable capital. It has *ex hypothesi* been repaid before they came into existence. These assets are distributable amongst the contributories in accordance with their contractual rights *inter se*, and the question I have to determine is the true interpretation of these rights in this case. In approaching the solution of this question it is to be borne in mind that every person who becomes a member of a company, limited by shares of equal amount, becomes entitled to a proportionate part in the capital of the company and, unless it be otherwise provided by the regulations of the company, entitled as a necessary consequence to the same proportionate part in all the property of the company. Preference shareholders are members of the company, and as much shareholders in it as the ordinary shareholders are, and they must be treated as having all the rights of shareholders except so far as they renounced those rights on their admission to the company. It is for the ordinary shareholders here to establish that the preference shareholders renounced their rights to participate in the surplus assets now distributable.

Further His Lordship said that even where the fact that preference shareholders ranked in priority did not imply that, that negatives any *pari passu* ranking and His Lordship supported this by saying that all shareholders whether preferential or ordinary aimed at success of the company and simply because a limit was placed on preferential dividend and the bulk of profit was divisible among ordinary shareholders while the company was a going concern did not mean that when it ceased to do business as in case of liquidation, the rateable division of surplus assets amongst the two classes of shareholders, was the just and equitable method. This was of course subject to any expressed term in the articles of association depriving the preferential shareholders in so many clear words of their right to share in the distribution of these surplus assets.

In the Appeal Court while confirming the above decision Lord Hanworth, M.R., quoting the case of *Inland Revenue Commissioners* v. *Burrell,* (1924) 2 *K. B.* 52 stated that in that case.

"After a careful examination of the relevant cases it was decided that this surplus retains no distinctive characteristics—it

is wrong to call it capital, but on the other hand, it is not a source of dividend, because no dividend can be paid; it represents undistributed profits accumulated, it may be during a number of years, but it cannot be dealt with as a fund for payment of dividends by the directors, or the winding up has displaced their power."

The other important case in this connection is *Birch v. Cropper,* (1889) 14 *App. Case* 525 where Lord Macnaghten stated

"I think it rather leads to confusion to speak of the assets which are the subject of this application as 'surplus assets' as if they were an accretion or addition to the capital of a company capable of being distinguished from it and, open to different considerations. They are part and parcel of the property of the company—part and parcel of the joint stock or common fund—which at the date of winding-up represented the capital of the company."

In the same case Lord Herschell said of the preference shareholders,

"They are members of the company, and as much shareholders in it as the ordinary shareholders are; and it is in respect of their thus holding shares that they receive a part of the profits."

Further at the end of his judgment His Lordship concludes that

"When the whole of the capital has been returned both classes of shareholders are on the same footing, equally members and holding equal shares in the company and it appears to me that they ought to be treated as equally entitled to its property."

As to winding up the question of preference was then dealt with by Lord Justice Cotton in *Re. Bridgewater Navigation Co.,* (1888) 39 *Ch. D.* 1 *on page* 25. His Lordship stated that on winding up

"All question of preference is now at an end, and the shareholders are to be dealt with as having equal rights, because the provision in the articles creating the preference shares as regards dividend to arise on the working of the capital is at an end."

The sum and substance of all these is that in case of preference shareholders in winding up, they have the same right in the distribution of surplus assets as ordinary or any other shareholders, in proportion to their holding

and this right could only be taken away by express provisions in the memorandum or articles of association.

We have of course seen that the right given to preference shareholders in connection with the division of profit, does not impliedly give the same preference right in connection with the division of capital unless so expressly mentioned (*Driffield Gas Light Co.*, (1898) 1 *Ch.* 451); and thus persons who purchase preference shares should make careful investigation as to what their rights will be in case of winding up, because otherwise, on reconstruction of the company they may be reduced to the position of holders of ordinary shares (*Briffiths* v. *Paget*, (1877) 6 *Ch. D.* 511). This principle was also laid down in the case above discussed, *viz.*, that of *Birch & Cropper*, (1889) 14 *App. Case* 525. In one case where the articles provided that the preference shareholders are to be given on winding-up "arrears of preference dividend" it was held that there are no arrears of such dividend payable out of profits of each year if the dividends were so payable and therefore there was no profit before the winding up. The same rule was applied to a case of cumulative dividends (*Espuela Land and Cattle Co., No.* 2, (1909) 2 *Ch.* 187; *W. J. Hall & Co.*, (1909) 1 *Ch.* 521). This decision was deferred from in *New Chinese Antimony Co.*, (1916) 2 *Ch. D.* 115 where the value of assets rose after the liquidation and the learned Judge held that there was profit before him to which the preference shareholders were entitled on account of their arrears from the date of the issuing to the commencement of the winding up. Thus on this question there is considerable difference of opinion and in absence of a final Appeal Court judgment nothing definite could be stated. The language of the articles of association also considerably influences the result in connection with preferential rights of members, *e.g.*, a declaration that the profits will be applied first in paying a dividend on the preference shares and secondly on the ordinary shares, would give the preferential shareholders a right of cumulative dividend unless the articles

also use the words 'each year' (*Webb* v. *Earle*, (1875) 20 *Eq.* 556). If there is any doubt or difficulty as to the exact rights of preferential shareholders, in competition with the other class of shareholders, the Court cannot look to the prospectus for arriving at a decision (*Chicago and North-West Granaries Co.*, (1898) 1 *Ch.* 263). It has been also held in England that where arrears of dividends are payable they must be paid without any deduction of income-tax (*In re. Dominion Tar & Chemical Co.*, (1929) 2 *Ch.* 387).

Frequently the preferential shareholders are prevented from voting at general meetings of the company by special articles of association and that rule seems to be binding, though in cases where they are also excluded from attending general meetings and are treated as if they were mere debenture holders, it is doubted whether the meeting which excludes one class of shareholders could be called a "general meeting." Of course there is no definite decision on this point. The preferential shareholders anyhow are under the Act entitled to receive and inspect *profit and loss account* balance-sheets and the reports of *directors* and auditors on the same footing as other shareholders. Where the preference shares are issued by a company without possessing the power to do so, or are issued in an irregular manner, the parties who have paid their money would be entitled to the refund of same and would stand in the position of creditors of the company (*London and New York Investment Corporation*, (1895) 2 *Ch.* 860; *Home & Foreign Investment Corporation*, (1912) 1 *Ch.* 72).

Participating Preference Shares

In case of these shares in addition to the fixed preference dividends which this class of shareholders are entitled to get, they are given a further right to share in the surplus profits after all the other shareholders have received a specified dividend. This right is given by a specific provision in the articles. In case when the articles

were being altered with a view to give preference shareholders a right to participate in surplus profits with ordinary shareholders rateably it held that separate meetings of ordinary shareholders was unnecessary (*Stewart Precision Carburettor Co.,* (1912) 28 *T. L. R.* 335; 56 *S. J.* 413).

The participation further than that laid down must be expressly stated, thus in one case, where a right to cumulative dividend of 10 per cent was provided for and no further mention was made as to participations or otherwise it was held that they could not take further than 10 per cent (*Will* v. *United Lankat Plantation Co.,* (1912) 2 *Ch.* 571; (1914) *A. C.* 11; *approved in Steel Corporation of Canada* v. *Thomas Ramsay,* (1931) *A. C. at p.* 274).

Guaranteed Preference Shares

These shares are those on which a certain percentage of dividend is guaranteed by the vendors or by third parties either for a stated period only or on other conditions. Such shares are issued in connection with the conversion of a private business into a limited company, or on the sale of one company to another company where the vendor or any other interested party undertakes to guarantee this specified rate of dividend for a number of years. This guarantee is given under a special agreement which is to be carefully drafted, because it may be that the guarantor may guarantee a dividend up to a certain percentage and the company may either pay less or more than the percentage he guarantees, in which case provision has to be made whether the higher dividend paid during subsequent years has to be a set-off against the lower dividend paid and thus an average arrived at as far as the guarantee is concerned.

There are cases where the articles declare that the preference shares are to be paid "arrears" of preferential dividends in winding up. It has been held that in cases where these dividends are to be paid from the profits of

each year, there would be no profit to divide if no profits were made before winding up (*Espuela Land & Cattle Co. No.* 2, (1909) 2 *Ch. D.* 187). It has also been decided that profits earned after winding up has commenced are divisible as capital and not dividend (*Bishop* v. *Smyrna and Cassaba Railway No.* 2, (1895) 2 *Ch. D.* 596). After liquidation the preference shareholder cannot claim a dividend on the ground that the same might have been declared (*Odessa Waterworks,* (1901) 2 *Ch.* 190 *N.*). However, there have been some conflicting decisions as in case where the values of assets rose after liquidation and there was a surplus. Neville, J., in *New Chinese Antimony Co., Ltd.,* (1916) 2 *Ch. D.* 115, disputed the proposition laid down in former cases and thought that preference shares are entitled to arrears as from the date of issue to the commencement of winding up. Here the learned Judge argued that " We have to deal with a fund which is not capital or income or profits but surplus assets. That is what we have to distribute. There is nothing to make any distinction between capital and income. The only point is what is meant by ' arrears of the preferential dividend aforesaid.' Arrears of dividend might mean only arrears of dividend which had been declared but I do not think that is what the words do mean. The clause in my opinion means that in the case of a winding up, the preference shareholders are to have their capital repaid in full and also certain cumulative preferential dividend of 10 per cent that is to say the amount they would have had if there had been profits enough to enable the company to declare dividends." Here the learned Judge then cited in support (*In Re. W. J. Hall & Co.,* (1909) 1 *Ch. D.* 521). This case, however, being a single judge's decision, no definite opinion can be given until the matter is decided by the Appeal Court. (See *In Re. William Metcalfe & Sons Ltd.,* (1933) 1 *Ch. D.* 142) as discussed in previous pages. See also (*Sringbok Agricultural Estates,* (1920) 1 *Ch.* 563; *In Re. Walter Symons,* (1934) *Ch.* 308). The point is that in connection with this payment of

preferential dividends, this clause of the articles has to be prepared with the greatest care, so that the intention of the promoters of the company are quite clearly stated beyond all doubt as to what is to be done in connection with the payment of these preferential dividends in case of winding up. Thus it should be made clear that in case of non-cumulative preference shares, the shareholders are to receive dividends out of the "profits of each year a preferential dividend for such year," that is out of the profits of that particular year only (*Adair* v. *Old Bushmills Distillery,* (1908) *W. N.* 24). If the preferential dividend is agree to be paid "out of the net profits of each year" and it is further provided that a dividend on the ordinary share should be paid thereafter, that does not give the preferential shareholders a right to receive cumulative dividend (*Staples* v. *Eastman & Co.,* (1896) 2 *Ch.* 303). Mr. Palmer in his book on "Company Precedents" suggests the following form :—

"The capital is £...............divided into................ preference shares of £.............each, and............ordinary shares of £................each. The said preference shares shall confer on the holder the right to be paid out of the profits of each year a fixed dividend for such year at the rate of 5 per cent per annum on the capital for the time being paid-up thereon, and such shares shall rank, as regards return of capital in priority to the ordinary shares (but shall not confer the right to any further participation in profits or assets). And upon any increase of capital the company is to be at liberty to issue any new shares with any preferential, deferred, qualified, or special rights, privileges or conditions attached thereto. (The rights for the time being attached to the preference shares in the initial capital or to any shares having preferential deferred, qualified, or special rights privileges or conditions attached thereto, may be altered or dealt with in accordance with clause..........of the accompanying articles of association, but not otherwise)."

He further states that another mode of expressing this is to say :—

"The rights to a fixed preferential dividend at the rate of 5 per cent per annum on the capital paid up thereon, such dividend

to be paid, as regards each year, out of the profits of each year only."

It may be added that there is no objection to the holder of preference shares being precluded from exercising the rights of voting, in other words, if they are not given any voting power at all at the general meeting (*Re. Mackenzie & Co.*, (1916) 2 *Ch.* 450). In this case it was also laid down that a resolution for reduction of capital can be passed in the absence of preference shareholders. The London Stock Exchange, however, has declared itself strongly against such a provision in the articles and prohibits the dealing of such shares on the exchange. The idea here is that the preference shareholders by an undue exercise of their votes may not control the direction of the company to the detriment of the ordinary shareholders, (who generally hold the bulk of the capital) by appointing directors, etc. to exercise powers in their (preference shareholders) favour. Frequently, pre-preference shares or shares with a second preference are also issued. The pre-preference shareholders get a preference in the payment of dividends even over the preference shareholders, whereas the second preference shareholders rank in priority to ordinary shareholders, but are deferred from the rights of the preferential shareholders. The other rights or privileges will naturally depend upon the articles or any other regulations which confer power upon them. In connection with preference shares it should be noted that in case there was an undertaking given to them to the effect that their rights should in all circumstances come first pre-preferential share cannot be issued (*James* v. *Buena Ventura Syndicate,* (1896) 1 *Ch. at p.* 456; *Welton* v. *Saffery,* (1897) *A. C.* 299). If however terms of issue of the preference shares laid down that they were issued subject to the right of the company to issue further capital with " such preferences and priorities as shall be agreed upon " or " on such terms as the company may determine," the preference shareholders cannot object to their rights upto dividend being postponed through the issue of fresh

shares (*Pulbroke* v. *Mew Civil Service Co-operation*, (1878) 26 *W. R.* 11; *Underwood* v. *London Music Halls*, (1901) 2 *Ch.* 309).

Redeemable Preference Shares

Our Indian Companies Amendment Act of 1936 following the English Act of 1929 has now provided in section 105B for the issue or redeemable preference shares. The English Act made this provision on the recommendation of the Greene Commission of 1925-26 on the ground that " the power to issue redeemable preference shares would prove useful in certain cases and provided that proper safeguards are adopted we see no reason why this power should not be given." According to the Special Law Officer's report to the Government of India of 1935 " the needs of modern times require that the company should have the power to issue redeemable preference shares. It has certainly proved very useful in England that proper safeguard provisions for the issue of such shares should also be made in our Act." Now it is provided that *subject to the provisions of Sec. 105B, a company limited by shares may, if so authorised by its articles, issue preference shares which are, or at the option of the company are to be redeemed. This is subject to the conditions that* (*a*) *no shares are to be redeemed except out of profits of the company which would otherwise be available for dividend or, out of the proceeds of a fresh issue of shares made for the purpose of redemption or out of sale proceeds of any property of the company,* (*b*) *no such shares are to be redeemed unless they are fully paid,* (*c*) *where any such shares are redeemed otherwise than out of the proceeds of a fresh issue, the company must out of the profits which would otherwise have been available for dividend transfer to a Reserve Fund, a sum equivalent to the amount applied in redeeming the shares. This reserve fund is to be called " Capital redemption Reserve Fund " and the provisions of this Act relating to the redemption of the share capital of a company, except as provided in this section,*

shall apply as if a capital redemption reserve fund was the paid-up share capital of the company and (d) where any such shares are redeemed out of the proceeds of a fresh issue, the premium, if any, payable on redemption must have been provided for out of the profits of the company before the shares are redeemed. Besides this, the further condition in connection with such issue is that in every balance sheet of a company which has issued redeemed preference shares, a statement shall be included specifying what part of the issued capital of the company consists of such shares and the date on or before which these shares are, or are to be liable to be redeemed or where no definite date is fixed for redemption, the period of notice to be given for redemption. Failure to comply with the provisions of this sub-section (2) of Sec. 105B shall entail on the company and every officer of the company, who is in default a fine not exceeding Rs. 1,000. The redemption of these preference shares may be effected on such terms and in such manner as may be provided by the articles of the company subject to the provisions of Sec. 105B. The further power given is that where in pursuance of this section a company has redeemed or is about to redeem any preference shares, it shall have power to issue shares upto the nominal amount of the shares redeemed or to be redeemed as if those shares had never been issued, and accordingly the share capital of the company shall not for the purpose of calculating the fee as payable under Sec. 249 be deemed to be increased by the issue of shares in pursuance of sub-section (4) of Sec. 105B. Where however the new shares are issued before the reduction of old shares, the redeemed shares shall not, so far as relates to Stamp duty be redeemed to have been issued in place of sub-section (4) to Sec. 105B unless the old shares are redeemed within one month after the issue of the new shares. Where these new shares have been issued in pursuance of Sec. 105B (4), the capital redemption reserve fund may, be applied by the company, up to an amount equal to the nominal amount of the shares so issued in

paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

It may be added in connection with the issue of redeemable preferential shares that the circumstances under which such an issue would be particularly valuable is where a company requires capital for expansion of its assets which he expects to repay out of profits at an early date and thus it provides for that capital, the dividends on which it will have to pay only during the period that such shares continue to be the capital of the company and are not actually redeemed. Thus the old shareholders would benefit inasmuch as they would reap the advantages and profits of these extensions made out of the capital raised on the redeemed preference shares.

Ordinary Shares

Ordinary shares are those shares, which in case where there are preference shares also, receive their dividend out of profits, after the preference shareholders are paid their dividends as per the rights given to them by the regulations of the company. In absence of their being deferred, or founders' shares, the ordinary shareholders have a right to share all the profits left after the payment of preference shareholders, and after due provisions are made by the directors for depreciation, reserve fund etc.

Deferred or Founders' Shares

Deferred, or founders' shares, are sometimes issued in limited numbers, which carry a right to dividend, after a fixed percentage is paid to the preference and ordinary shareholders, respectively. Generally, holders of founders' shares are entitled to a division among themselves of the whole or proportionate profits, left after the payment of the dividends to the first two classes named above, of course after all due provisions are made by the directors, as per the regulations of the company. These shares came to be called founders' shares, because they were originally

i.e., in the early days of joint stock enterprise, created to remunerate the founders of the company whose rights were deferred to those of the other classes of shareholders. In practice, it was noticed later that, in certain speculative concerns, such as mining companies, the founders' shares earned large profits. It is therefore the modern practice to allot founders' shares only to those who apply for a certain number of ordinary, or preference shares, with a view to attract capital in concerns where such founders' shares are considered a good investment. In concerns where these shares carry with them the right to the balance of profits, or certain portion of the profits left out after distribution of dividends among the other classes, the tendency to set aside as little as possible for the reserve fund is great, particularly where the directors themselves hold a large number of these shares. Of course, it is entirely within the rights and powers of the board of the directors while ascertaining what is the profit available for dividend, to take as much to reserve fund as in their opinion and discretion the interests of the company concerned require, or make it imperative, and in doing so they need not be restrained by the idea that the founders' shares do not get any dividend (*Fisher* v. *Black and White Publishing Co.*, (1901) 1 *Ch.* 173). In one case it was decided that the exchange of founders' or deferred shares, for a larger amount of ordinary shares, amounted to issuing of the said shares at a discount and was therefore bad (*Development Co. of Central and West Africa*, (1902) 1 *Ch.* 547; *Anglo-French Exploration Co.*, (1902) 2 *Ch.* 845). It is best to provide in the articles to the effect that the premium on issue of shares is not to be reckoned as a profit divisible among the holders of the founders' or deferred shares, as otherwise, they will be entitled to claim same as such (*Re. Hoare & Co.*, (1904) 2 *Ch.* 208). Mr. Palmer in his "Company Precedents" states as follows while dealing with founders' or deferred shares :—

"In the case of founders' and deferred shares, the

terms of issue not unfrequently lead to difficulty and dispute as regards the determination of the amount of the profits to be distributed. The holders of the founders' shares may complain that too much is carried to reserve, that the profits are ascertained on too conservative a basis, and that, the directors unduly favour the other shareholders. On the other hand, if dividends on a large scale are paid on the founders' shares the other shareholders commonly complain that the founders get too much, that the directors unduly favour them, and that the desire to pay a dividend to the founders leads to speculative business, and diverts to the founders' shareholders' pockets what ought to go to reserve. Those difficulties can, to a great extent, be met by giving to the holders of the founders' shares, as in the above form, a fixed aliquot share in the profits which it shall be determined to distribute, and not merely in the surplus profits themselves."

There was a practice in England some years ago to exchange founders' or deferred shares of lesser value with ordinary shares of larger value but that has been declared as equivalent to issuing ordinary shares at a discount and therefore unlawful (*Development Company of Central West Africa,* (1902) 1 *Ch.* 547).

Mr. Palmer also suggests that in settling the capital clause the counsel should direct his attention to three points; first being whether these shares are to confer a right to the percentage of the divisible profit of each year or of the surplus profits after paying specified dividends on other shares. Secondly what rights they are to confer in winding up and thirdly whether they are to confer any special voting rights. In connection with the first point the divisible profits are the profits which the directors have set aside to be distributed by way of dividend after making all necessary provision for reserve fund, depreciation, etc. The surplus profit would necessarily include that and naturally difficulties arise here which the draftsman has to make clear. The usual practice is to allocate a proportion of the surplus profit which usually remains each

year after paying or providing for the payment out of profits of a dividend of specified percentage to the preference shares and another specified percentage to the ordinary shares on their paid-up amount, say half of such surplus left may be divided among the deferred shareholders.

The Reserve Capital

In case of companies like banking companies, where financial credit is of considerable importance, a certain portion of its capital is declared to be uncallable during the regular course of the existence of the company, and is only to be called in case of winding up. It is thus possible to provide for a substantial amount available for the benefit of creditors in case the company was to be wound up through failure of the enterprise. The Section 69 of our Act of 1913, lays down that :—

A limited company may by special resolution determine that any portion of its share capital which has not been already called up shall not be capable of being called up, except in the event and for the purposes of the company being wound up, and thereupon that portion of its share capital shall not be capable of being called up except in the event and for the purposes aforesaid.

With regard to unlimited companies Section 68 lays down that :—

An unlimited company having a share capital may, by its resolution for registration as a limited company in pursuance of this Act, do either or both of the following things, namely :—

(*a*) Increase the nominal amount of its share capital by increasing the nominal amount of each of its shares, but subject to the condition that no part of the amount by which its capital is so increased shall be capable of being called up except in the event and for the purposes of the company being wound up :

(*b*) Provided that a specified portion of its uncalled share capital shall not be capable of being called up except in the event and for the purpose of the company being wound up.

This reserve capital once created cannot be altered into ordinary capital without the leave of the Court and this reserve liability cannot even be charged or mortgaged by the directors (*Bartlett* v. *Mayfair Property Com-*

pany, (1898) 2 *Ch.* 28). It may be however added that in considering the solvency, or otherwise, of the company the figure of reserve liability cannot be reckoned among assets (*Bristol Joint Stock Bank,* (1890) 44 *Ch. D.* 703).

Reserve capital is also known by the other name of Reserve Liability and it has been held that it may be created by the articles and where it is created by an article it may be altered by special resolution to make the reserve callable (*Malleson* v. *National Insurance Corporation,* (1894) 1 *Ch.* 200).

From the above section it is clear that if special resolution is passed with a view to create reserve liability that would be unalterable, though a reserve liability created by article itself is alterable.

Resolution to create Reserve Capital or Reserve Liability

Resolved :—That the capital of the company to the extent of Rs. 200 in respect of each of the shares of Rs. 1,000 each as at present issued which has not been called up shall not be capable of being called up except in the event and for the purposes of the company being wound up.

There is one more question of importance applying to reserve capital, *viz.*, whether the same can be charged or mortgaged by the company under a power in its memorandum or articles to charge its uncalled capital. *Lindley, M. R., In re. Mayfair Property Co.,* (1898) 2 *Ch.* 28, laid down that it cannot be done. According to his Lordship the Act of 1879 which brought the "reserve liability" in existence as a system aimed at (1) preserving for the general creditors of the company the funds which the members were liable to pay, but which the directors could not call up and (2) to enable the members to limit the amount of their liability on a winding up to pay the creditors more than the amount preserved for them. The first object would be entirely defeated if the reserved capital could be charged or mortgaged. Palmer (p. 289 Palmer's Company Law 25 End.) differs from

this view as according to him "the words of the Act do not justify the conclusion." However, this is the law as long as this unanimous judgment of the Appeal Court made up of eminent judges is not upset.

Managing Agency Clause

According to Indian practice, a firm constitutes itself or is appointed as the managing agents of a joint stock company by special agreement between it and the company, by virtue of which the said firm acts as managers, secretaries and treasurers for a remuneration. In many cases, these firms of managing agents insert the statement as to their appointment in the objects clause of the memorandum of association and in other cases have inserted additional clauses to the usual clauses of the memorandum of association, with the same object. These clauses at one time could not be altered as the alteration did not fall within the provision of S. 12 (*Ashbury* v. *Watson,* (1885) 30 *Ch. D.* 376). Though where the memorandum itself gave power to alter such a clause that could be done (*Welsbach Incandescent Gas Co.,* (1904) 1 *Ch.* 87). Now however by the Indian Companies (Amendment) Act, 1936, this can be done under the proviso to S. 10 of the Act. Apart from the separate agreement which is generally entered into in such cases between the managing agents and the company, there is no binding force in these clauses because it has been held in both English and Indian cases that the memorandum and articles of association of a company embody only the social contract, that is a contract between the shareholders *inter se* and possibly between the shareholders and the directors and do not constitute any contract between the company and its promoters (*Ahmedabad Jubilee S. & M. Co.* v. *Chhotalal Chhaganlal,* (1908) 10 *Bom. L. R.* 141; *Eley* v. *Positive Government Assurance Company,* (1876) 1 *Ex. D.* 88). The managing agent or managing director of a registered company is held to have no implied authority to purchase on behalf of the company the liability of a stranger and still less that of their own

partner or manager incurred in a private transaction of their own (*Raja Bahadur Shivlal Motilal* v. *The Bombay C. M. Co., Ltd.,* (1915) 17 *Bom. L. R.* 484).

Two typical clauses of this type may be quoted here :—

ILLUSTRATION No. 1.

"The members who at present constitute, or who may hereafter constitute, the firm of Messrs. A. B. C., and Company and their successors in business, notwithstanding any change which may take place by the addition of any partner or partners, or by the death or retirement of any partner or partners, are hereby appointed Agents of the Company for a period of . . . years from the date of the registration of the Company, in terms of the agreement a form whereof is subjoined to the Articles of Association as Schedule B, which agreement is to be entered into between the Company and the said firm of Messrs. A. B. C. & Co. with or without modification. And it is hereby expressly provided and declared, that in consideration of the services rendered by them in promoting this company, the appointment of the said firm of Messrs. A. B. C. & Co. to the office of Agents of the Company, shall not be liable to be revoked or cancelled during the said period of . . . years, on any ground or for any reason whatsoever, save and except their being found guilty of misconduct or fraud in the management and discharge of their duty as such agents of the company."

ILLUSTRATION No. II.

(1) *To appoint Messrs. X. Y. Z. & Co., Limited,* (herein called the Agents or the Agents' firm) the secretaries, treasurers and agents of the company.

Such appointment of the agents' firm and the payment of commission to them is hereby confirmed upon the terms, for the remuneration and with powers, and for the consideration set forth in the draft agreement annexed herewith as per Schedule.......... and in terms of the articles of association, which terms may be revised, modified, or altered from time to time in such one or more or all particulars as the board of directors and agents may both jointly agree to.

It is hereby expressly provided and declared that in consideration of the services mentioned hereafter in the Schedule...... and the articles of association, and to be rendered as Secretaries, treasurers and agents, the appointment of Messrs. X. Y. Z. & Co., Ltd. to the office of secretaries, treasurers and agents of the company shall not be liable to be at any time hereafter revoked or cancelled on any ground or for any reason whatsoever save and

except as provided for by the Indian Companies Act 1913 as amended upto 1936.

NOTE:—Under the Indian Companies (Amendment) Act of 1936, it is now provided *that no managing agent shall be appointed to hold office for a term of more than twenty years at a time after the commencement of this Amendment Act.* [*Sec. 87A (1)*]. *It is further provided that in case of old companies, i.e., those which were incorporated before the commencement of this Amendment Act, the managing agent shall not continue to hold office after the expiry of twenty years from the commencement of the said Amendment Act notwithstanding anything to the contrary contained in the articles of the company or in any agreement with the company, unless he is reappointed to his office or unless he has been reappointed thereto before the expiry of the said twenty years* [*Sec. 87A (2)*].

It should be further noted that under Sec. 87B the managing agent who is convicted of an offence in relation to the affairs of the company punishable under the Indian Penal Code and being under the provisions of the Code of Criminal Procedure, 1898, non-bailable may be removed by resolution passed at a general meeting of which notice has been given to the said managing agent [*Sec. 87B (1)*].

Again the office of a managing agent will now be vacated if he is adjudged an insolvent [*Sec. 87B (b)*]. *The contract of a managing agent in case of a company which is wound up either by the court or voluntarily terminates without prejudice however to his right to recover any moneys recoverable by him from the company unless where the Court finds that the winding up is due to the negligence or default of the managing agent himself, in which case the managing agent shall not be entitled to receive any compensation for the premature termination of his contract of managing agency* [*Sec. 87B (e)*].

Under these circumstances, the clauses in the memorandum and articles to the effect that the managing agents shall hold office until they voluntarily resign or for a period which exceeds the period laid down above are now void and inoperative.

(2) To authorise the board of directors on behalf of the company to enter into, execute and carry into effect the arrangements made from time to time between the company and the agents' firm as per Schedule........ or otherwise. The said Board is further authorised to modify and consent to the terms and conditions as may be agreed upon from time to time between the company and the said agents' firm in connection with the Schedule.

(3) They entitle the agents' firm or any member thereof to work in Ahmedabad or elsewhere and have dealings with this com-

pany as buying and selling agents for cotton, yarn, cloth machinery, and accessories, stores, of every description and all other articles etc., and for this the said agents shall be entitled to receive remuneration in addition to the commission as Secretaries, Treasurers, and Agents.

NOTE :—In this connection it should be noted now that the Indian Companies Amendment Act of **1936** has made drastic alterations in the position of managing agents with which we shall deal later in detail. *The first alteration is that in case of any appointment of the managing agent after the commencement of the Amendment Act the remuneration must be a sum based on a fixed percentage of net annual profits of the company, with provision for a minimum payment in the case of absence of or inadequacy of profits, together with an office allowance to be defined in the agreement of management, the net profit is also carefully defined [Sec. 87C (1) and (3)]. It is further laid down that any stipulation additional to or in other form than the remuneration satisfied as above shall not be binding on the company unless sanctioned by a special resolution of the company [Sec. 87C (2)].*

In case of the right of the managing agent to contract with the company, it is laid down that except with the consent of three-fourths of the directors present and entitled to vote on the resolution, the managing agent or the firm of which he is a partner or any partner of such firm or where the managing agent is a private company a member or director thereof shall not enter into any contract for the sale, purchase or supply of goods and materials with the company, provided that nothing herein contained shall affect any such contract for such sale, purchase or supply entered into before the commencement of the Indian Companies Amendment Act of 1936 [Sec. 87B (5)].

Illegal Object

In a recent case where the principal objects of a company included the business of conducting a lottery, the Court held that the objects were illegal and ordered the company to be wound up and refused to allow it to carry on its business even after removing the obnoxious features from its objects as by such removal the substratum of the company would go (*Universal Mutual Aid and Poor House Association, Ltd.* v. *Thoppa Naidu*, (1933) 56 *Mad.* 26).

CHAPTER V

Alteration in the Memorandum of Association

The alteration of the memorandum of association of a company can only be made in certain defined cases and in the manner provided for by the Indian Companies Act of 1913. The exact language of the section which lays down this rule is, "A company shall not alter the conditions contained in its Memorandum except in the cases and in the mode and to the extent for which express provision is made in this Act, *provided that any provision in the memorandum relating to the appointment of a manager or the managing agent and other matters of a like nature incident or susidiary to the main objects of the company shall not be deemed to be such condition.*" The words in italics have been added by the Amendment Act of 1936. This proviso now makes it possible to alter extranuous clauses which are added in the memorandum with respect to contracts with managing agents, etc., which under the old law could not be done. Thus all old decisions on this question are now obsolete. (Sec. 10). The variation of the memorandum may be made with one or more of the following aims in view :—

(*i*) For the purpose of changing the name of the company (Sec. 11)

(*ii*) For the purpose of varying either the place of business of the registered office of the company from one province to another

(*iii*) For the purpose of altering one or more of the objects of the company (Sec. 12)

(*iv*) For the purpose of varying the amount of the company's capital or for reorganisation (Sec. 50 and 54).

ALTERATION OF NAME

The name of a company can be altered by a special resolution and subject to the approval of the Local Government in writing. [Sec. 11 (4)]. In England the board of trade has to sanction the change of name and the principle followed there, which is the guiding principle here also, is that a change in name which appears to alter the main object or is inconsistent to it is not sanctioned. Such a change of name shall not affect any rights or obligations of the company, or render defective any legal proceedings by or against the company. Where such a change of name is duly carried out, the registrar shall enter such new name on the register, in place of the old name and shall issue an altered certificate of incorporation to meet the circumstances of the case. The issue of such a certificate shall complete the change of name. [Sec. 11 (5)].

It may be added that no change of name will make any difference as far as any rights or obligations of the company are concerned, nor shall it render defective any legal proceedings by or against the company; and any legal proceedings that might have been continued or commenced against it by its former name may be continued or commenced against it by its new name. [S. 11 (6)]. It is further provided by S. 11(2) that if through inadvertence or otherwise a company is registered by a name too closely resembling that of an already existing company, the first named company may, with the sanction of the registrar change its name. There are cases, however, where the Courts have allowed an alteration in the objects of the company only where the company has correspondingly altered its name to suit the position it is likely to occupy through the extension of such an object (*Foreign & Colonial Government Trust Company*, (1891) 2 *Ch. D.* 395). The Indian Mechanical Gold Company was permitted to extend its object to include places outside India on altering its name by adding the words "And General" to it (*Indian Mechanical Gold Company,*

(1891) 3 *Ch. D.* 538). The Egyptian Delta Land Company was similarly permitted to extend its objects by adding the words "And Soudan" to its name after "Delta" (*Egyptian Delta Land Company,* (1907) *W. N.* 16). The tendency of the modern Courts is of a more liberal character and nowadays it is seldom that a change of name is insisted on side by side with the extension of the objects (*Trust and Agency of Australasia,* (1908) *W. N.* 229). Here the company wanted to extend its operations from Australasia to Argentina, which was permitted without change of name.

When the company alters its name it should immediately get its altered name entered in the register by the registrar in place of its former name and get a new certificate of incorporation or the original certificate altered to meet the case. This is essential because unless this course is followed the change of name is not complete and till then the company remains in existence in law under its original name (*Shackleford, Ford & Co.* v. *Dangerfield,* (1868) *L. R.* 3 *C. P.* 407 *at p.* 411). If, however, it is discovered, after the certificate is issued altering the name, that a special resolution required by the Act was not properly passed, an application may be made to the registrar to vacate the registration (*Re. Astralasian Mining Co.,* (1893) *W. N.* 74). Of course this change of name does not, as we already noticed, in any way alter the position of the company as far as its rights and obligations are concerned and any legal proceedings that may have been taken prior to such alteration can be continued in its former name [S. 11(6)].

Where a company had sold its assets and good-will in liquidation to certain purchasers who formed a new company under a new name and took over the assets, it was held that no injunction can be granted against the use of the original company's name by a person who did not represent himself as the successor of such company and whose user had been acquiesced in by the liquidator of the old company and the purchaser of its good-will

(*Montreal Lithographing Co.* v. *Sabiston,* (1899) *A. C* 610).

New Company with Identical Name with Old in Liquidation

Where a company is being wound up and a new company is being formed to do similar or different business under the same name the course to be followed is to first file, or register, the resolution placing the old company in liquidation and then to file the consent of the old company to the registration of the new company under its old name. If on the other hand the new company is formed to take over and carry on the business of the old company the registrar may allow the identical name to be used with the year of incorporation of the new company, on production of the memorandum and agreement of sale, or transfer, from the old to the new company, recording this acquisition of the old company's business by the new. The old company has to give its consent under seal and agree to go into liquidation in two months.

Procedure as to Change of Name

With reference to the procedure to be adopted in connection with change of name, the first step should be to ascertain from the registrar whether there is any objection to the proposed change in view of its resemblance with that of an already existing company in the same line of business. The next step should be to obtain consent in writing from the Local Government as provided for in S. 11 (6) (here the reason for requiring the change of name must be stated in the application) and then to pass a special resolution in the following form :—

RESOLVED :—That the name of the company be changed to "The Himalaya Silk Manufacturing Company, Limited."

This change will come into force as soon as the new Certificate of Incorporation with the altered name is issued to the Company (*Shackleford, Ford & Co.* v. *Dangerfield,* (1868) *L. R.* 3 *C. P.* 407).

The next step will be to obtain from the registrar a certificate of incorporation in the new name.

Change of Situation and Objects

With regard to the alteration of the memorandum with a view to change the situation of the registered office of the company, or with a view to the alteration of the objects clause, the same can only be done by passing a special resolution, on its being shown to the satisfaction of the Court that such an alteration is rendered necessary for one or more of the following reasons :—

(*a*) To carry on its business more economically or more efficiently; or

(*b*) To attain its main purpose by new or improved means; or

(c) To enlarge or change the local area of its operations; or

(*d*) To carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company; or

(*e*) To restrict or abandon any of the objects specified in the memorandum.

The Court confirming the alteration requires to be satisfied that every holder of the debenture of the company has been duly notified, as well as sufficient notices are sent to any person, or class of persons, whose interest will, in the opinion of the Court, be affected by such an alteration. Besides this, every creditor who, in the opinion of the Court, is entitled to object and who signifies his objection in the manner directed by the Court, has to be either made to consent to the alteration, or his claim should be satisfied or secured to the satisfaction of the Court. (S. 12). The Court may make an order confirming the alteration either wholly or in part and on such terms and conditions as it thinks fit and may make such order as to costs as it thinks fit. (Ss. 12 and 13).

The Procedure as to Alteration of Objects

The procedure to be followed here is to draft the necessary resolution as to alteration of objects and get same approved by the board of directors. At the same meeting of the board the dates of the meetings of the company for passing and confirming the resolution as special resolution should be fixed and authority taken for giving notice to call the extraordinary meetings of members. After the special resolution is confirmed a copy of same must be filed with the registrar within 15 days from the date of confirmation. The next step is to petition to the Court for confirmation of the alteration. After presentation of the petition directions as to the date fixed for hearing, advertisement of the petition, the service of notice to debenture holders, creditors and other persons whose interests are likely to be affected in the opinion of the Court should be obtained. Creditors entitled to object and objecting should be paid out or satisfactorily secured or their consent obtained as to the alteration. The Court will also have regard to the right of minority of shareholders, or class of shareholders, who dissent to the alteration and may even adjourn or grant time, with a view to enable arrangements being made for their interests being bought over. The Court at its discretion may make the order confirming the alteration either wholly or in part or on such terms and conditions as it thinks fit (*Re. Spiers & Pond*, (1895) *W. N.* 135; *Ulster Marine Co.*, (1891) 27 *L. R. Ir.* 487). The Court may, in case of any person or class for special reasons, dispense with the notice as required above. (Ss. 12 and 13). /A certified copy of the order confirming the alteration together with a printed copy of the memorandum as altered shall be filed by the company with the registrar within three months of the date of the order, and the registrar shall certify the registration which certificate shall be conclusive evidence that all requirements of this Act with respect to the alteration and the confirmation have been complied with. When the alteration involves transfer of the re-

gistered office from one province to another, a certified copy of the order confirming such change shall be filed with the registrar in each such province and each registrar shall issue certificate of such registration (S. 15). It should be noted that the alteration shall have no operation until registration as above and after the expiry of three months as provided above shall be null and void subject to revival by the Court on sufficient cause shown on application made within a further period of one month. (S. 16).

The Law as to Alteration of Objects

The alteration of the objects will not mean the introduction of an entirely new object. (*Re. Cyclist's Touring Club,* (1907) 1 *Ch.* 269). This view of law has been considerably modified of late and Courts of Law seem to have given a more liberal construction to the S. 12 of the Indian Companies Act, 1913. In *Re. Parent Tyre Co., Ltd.,* (1923) 2 *Ch. D.* 222 the principle laid down is that in case where a company wishes to alter its memorandum by adding a business, that business may be wholly different from and bearing no relation to the then existing business of the company and yet be capable of being " conveniently and advantageously " combined with it, provided such new business is not " destructive of " or " inconsistent with " the existing business. It was further laid down here that this question whether the new business can be conveniently or advantageously combined with the existing business is a question for the company's managers and shareholders to decide. In this case the *Parent Tyre Co.,* according to the objects clause originally provided for, was authorised to take over and carry on the business of a manufacturer of pneumatic tyres and to do business in cycles, carriages, etc. There was no provision to enable the company to carry on the business of bankers or financiers and it was sought to get these powers. Here they were permitted to do so on the grounds stated above. Frequently it happens that when an objects clause is

altered, the Court may order a corresponding alteration in the name of the company. The Court has also the discretion to limit the scope of the proposed alteration by striking out a part, if so thought necessary, though generally speaking, it is not the concern of the Court to decide upon the desirability or otherwise of the alteration. All that it has to see is whether the proposed alteration is fair and equitable between the various members and between various classes of members (*Jewish Colonial Trust*, (1908) 2 *Ch.* 287). The Court must, however, protect the interests of the dissentient minority. The latest case is that of *In Re. Sicilifs Poultry Breeders Association, Ltd.*, 49 *T. L. R.* 4 (*also* (1933) 1 *Ch.* 227) where the memorandum, in its objects clause, prohibited the payment of and remuneration to or division of any profit among the members of the governing body. The business membership had so greatly increased that it was found necessary to pay the members of the governing body. On an application to alter the objects with a view to take power to remunerate the members of the governing body the Lower Court refused to sanction this alteration holding that, that would bring about fundamental change in the constitution of the company. The Court also thought that it had no jurisdiction to confirm alterations inconsistent with the original objects of the association. This decision was reversed in appeal, the Master of Rolls holding that the object of the Companies Act was to prevent too easy a change of the memorandum; but there was no desire to shut out the possibility of attaining more efficiency by "new and improved means." The main purpose of the Association being to improve the breeding of poultry the payment was necessary to improve efficiency (See also observations of the Judges in *Incorporated Glasgow Dental Hospital* v. *Lord Advocate*, (1927) *S. C.* 400) *In Re. Society For Promoting Employment of Women*, (1927) *W. N.* 145 was distinguished here because in that case the Court was dealing with an application to cancel something on which the existence of the company rested.

The Court may, if it thinks fit, adjourn the proceedings, in order that an arrangement may be made to the satisfaction of the Court for the purchase of the interest of the dissentient members, and may give such direction and make such orders, as it may think expedient, for facilitating or carrying into effect any such arrangement. (S. 14).

It has been also held that additional provisions, than those provided for by the Act inserted in the memorandum without qualification, become conditions of the company's constitution and cannot be altered (*Ashbury* v. *Watson*, (1885) 30 *Ch. D.* 376). With the sanction of Court a company can alter the memorandum of association by taking power to sell its property and assets but not the undertaking of the company (*Metropolitan Reversions Ltd.*, (1928) *Scots Law Times*, 299). When the alteration is confirmed, a certified copy of the order confirming this alteration, together with a printed copy of the memorandum as altered, shall, within three months from the date of the order, be filed by the company with the registrar. The registrar after registering the same certifies the registration under his hand.

If the alteration involved a change in the situation of the registered office from one province to another, a certified copy of the order confirming such a change has to be filed with the registrar in each of such provinces, and each such registrar has to certify the registration of the company. (S. 15).

As we have already seen the principle followed by the Court is to decide the question whether the alteration contemplated is fair and equitable as between the members of the company. The Court is not concerned to consider the wisdom or desirability of the proposed alteration (*In Re. Jewish Colonial Trust, Limited,* (1908) 2 *Ch. D.* 287).

It has been held that a company which has no members cannot pass a special resolution and thus the alteration of its objects cannot be sanctioned (*Re. Blackburn Philanthropic Insurance Co.,* (1914) 2 *Ch.* 430).

The alteration must be an alteration of the objects of the company but need not be an alteration of the objects clause as all the objects are not necessarily contained in that clause (*Incorporated Glasgow Dental Hospital* v. *Lord Advocate*, (1927) *S. C.* 400). The tendency of the Courts of the present times, as we have seen above, is to place a broader construction on the question of alteration of the memorandum than was formerly the case as we have already seen in (*Re. Parent Tyre Company Case*, (1923) 2 *Ch. D.* 222), which tendency has been further brought out in (*Re. North of England Protecting and Indemnity Association*, (1929) 45 *T. L. R.* 296) a company formed to carry on the business of manufacturers of footwear and other articles was allowed to alter its memorandum by the Court of Appeal in order to carry on some sixty different classes of business and finally "generally the business of a universal stores," on the ground that a large number of businesses were already carried on by the company and the application was to regularise the past (*In Re. Bolsom Bros. Ltd.*, (1935) *W. N.* 50; (1935) 1 *Ch. D.* 413). The Court will not now sanction an alteration which provides that each paragraph of the objects clause is to be a separate and distinct power (*Re. John Brown Ltd.*, (1914) 84 *L. J. Ch.* 245). Of course the Court has the complete right either to confirm the alteration or to refuse it or to accept the alteration in part or may add words limiting the generality of the proposed limitation or to strike out the additions or a portion of them (*Re. Spiers and Pond*, (1895) *W. N.* 135; *Ulster Marine Co.*, (1891) 27 *L. R. Ir.* 487). In one other case it was laid down that an outsider cannot come and oppose the alteration of the objects clause by suggesting that the new powers may be used against him with a view to infringe his rights as a competitor (*Hearts of Oak Life Assurance Co.*, (1920) 1 *Ch.* 544). Again the Court may insist on an alteration in the name before permitting an alteration which seeks to extend the scope of the business. Thus the *Indian Mechanical Gold Company* was permitted as shown above, to extend its objects so as to include

places outside India on its agreeing to add in its name the words "and General" (*Indian Mechanical Gold Co.*, (1891) 3 *Ch.* 538). A telephone company was permitted to supply electricity for other purposes and a marine insurance company was allowed to extend its business with a view to do business in risks of carriage by land and to life, fire and accident insurance connected with transit by land or sea also with appropriate alteration in name (*Oriental Telephone Company*, (1891) *W. N.* 153; *Alliance Marine Insurance Co.*, (1892) 1 *Ch.* 300). A company which had no power to borrow was permitted power to borrow and raise money for its business and secure repayment thereof by bonds, debentures, etc. (*In Re. Reversionary Interest Society Ltd.*, (1892) 1 *Ch.* 615). A single ship company has been permitted to own more ships (*Bernicia Steamship*, (1900) *W. N.* 24). Powers to lease or sell the whole of their undertaking or to amalgamate with or purchase other undertakings has also been permitted (*Anglo-American Telegraph Co.*, (1911) 105 *L. T.* 947; *The New Westminster Brewery Co.*, (1911) 105 *L. T.* 946; *Marshall Sons & Co.*, (1919) *W. N.* 207). It may be further added that generally speaking in cases of alteration of objects clauses, if there is an opposition which is reasonable, the Court would look upon it as wholesome and would allow cost on the opposing petition even though unsuccessful unless the same is entirely frivolous (*In Re. Parent Tyre Case*, (1923) 2 *Ch.* 222). The Courts have also refused to alter a memorandum which has been drafted in the old form with very few clauses mainly with the view to set out at length in modern form a number of powers or objects which the company already possessed (*Consett Iron Co.*, (1901) 1 *Ch.* 236; *D. & D. H. Fraser Ltd.*, (1903) 19 *T. L. R.* 364). Before confirming an alteration the Court must see that sufficient notice has been given to every holder of debentures of the company and to all persons and classes of persons whose interests are likely to be affected by the alteration. The Courts, of course, have power to dispense with notices, etc., and

thus where a company of seven persons never carried on business, the Court dispensed with all advertisements and advertisements were also dispensed with in a case where the Court considered alike the persons who actively dissented and those who did not assent (*Governments Stocks Investment Co. No.* 1, (1891) 1 *Ch.* 649). The Court sometimes adjourns the proceedings with a view that an arrangement could be made to the satisfaction of the Court for the purchase of the interests of dissentient members, but of course that will have to be done without applying any part of the capital of the company in the same.

In one case an application was made to the Court under Sec. 54 under the excuse of reorganisation of share-capital under the circumstances that the company had fixed by its memorandum the authorised capital at Rs. 10 crores divided into 20 lakhs preference shares of Rs. 10 each and 80 lakhs ordinary shares of Rs. 10 each, of which 20 lakhs preference shares and 40 lakhs ordinary shares were issued and fully paid. The Preference Shares were carrying a cumulative preferential dividend of 7½% with preferential rights as to capital and dividend arrears in liquidation. The company made losses to the extent of Rs. 3,50,00,000. By special resolution the authorised capital was reduced from 10 crores to Rs. 2,50,00,000 and in reorganising the share-capital the company converted the existing 20 lakhs preference shares of Rs. 10 each into 20 lakhs ordinary shares of Rs. 10 each. Whereas the 40 lakhs ordinary shares of Rs. 10 each were converted into 40 lakhs of deferred shares of Re. 1 each. The new classes of shares were given different rights by this special resolution. They were also confirmed at two class meetings of the preference and ordinary shareholders respectively as required by the proviso to Sec. 54(1). The Court dismissed the petition on the ground that two modes of reorganising share-capital only applied to Sec. 54 *viz.*, (1) the consolidation of shares of different classes into shares of one class, and (2) division of shares

of one class into shares of different classes. Therefore the proposed scheme was held not to be a scheme for dividing shares into different classes but a scheme for the total abolition of the existing classes and the creation of fresh classes of shares to which Sec. 54 had no application (*In Re. E. D. Sassoon United Mills, Ltd.,* (1928) 30 *Bom. L. R.* 598).

Sanction Subject to Modification

Frequently the Courts have sanctioned the alteration of objects subject to modification or alteration by the Court itself and in connection with such modification, the later decisions do not require any further special resolution approving such modifications limiting objects as was the case formerly. Thus *In Re. Spiers and Pond, Limited,* (1895) *W. N.* 135(2) the Court held the words which sought to effect the alteration to be too wide and decided that as they had the power to confirm an alteration " in part ", they could confirm the alteration with the addition at the end of the sentence of the limiting words " incidental thereto." The other case was *In Re. Fleetwood Estate Company,* (1897) *W. N.* 20, where the Court sanctioned resolutions extending the objects defined in the memorandum of association adding words to the language of the resolution, so as to limit the extended objects.

Though the alteration of the objects clause is more liberally allowed of late as we have noticed in recent decisions such as the *Parent Tyre Company Case,* (1923) 2 *Ch. D.* 222, the Court would refuse to sanction an alteration which involves an abandonment of objects of a fundamental character (*In Re. Jewish Colonial Trust,* (1908) 2 *Ch. D.* 287; *Universal Mutual Air & P. H. Assn., Ltd.* v. *Thoppa Naidu,* (1933) 56 *Mad.* 26). With the sanction of the Court a company can alter its memorandum of association by taking power to sell its " property and assets " but not the undertaking of the company (*Metropolitan Reversions, Ltd.,* (1928) *Scots Law Times,* 299). In one case a joint stock company had its memo-

randum providing that its capital should be divided into preference, second preference, ordinary, and deferred shares and further providing that second preference share shall rank for division next after the preference shares of the company and should confer on the holders thereof the right to a fixed cumulative preference dividend at the rate of $7\frac{1}{2}\%$ per annum on capital. Owing to the fact that profits were insufficient to pay dividend on second preference shares the dividends fell into arrears. The directors prepared a scheme for some other purpose which affected the preferential rights of the second preference shares with respect to arrear dividends and also the rights of the ordinary and deferred shareholders in surplus profits. The company therefore petitioned the Court for sanction of a scheme under Sec. 153 of the Indian Companies Act, 1913, for certain arrangements arrived at between the second preference, ordinary and deferred shareholders under powers given to them by the articles of association. In this case the Court held that they had power under Sec. 153 to sanction a scheme involving an alteration of the memorandum. They followed *in Re. Palace Hotel Ltd.*, (1912) 2 *Ch.* 438; *in Re. Schweppes Ltd.*, (1914) 1 *Ch.* 322; *and in Re. J. A. Nordberg Ltd.*, (1915) 2 *Ch.* 439. The Court further laid down the principle as enunciated *in Re. Alabama, New Orleans T. P. J. Railway Company,* (1891) 1 *Ch.* 213 *at pp.* 238 *&* 239, *viz.*, that what the Court had to do was to see, first of all, that the provisions of the statute have been complied with and secondly that the majority had been acting *bona fide,* next that the minority was not being overridden by the majority having interests of its own clashing with those of the minority whom they seek to coerce. The next principle was that the Court had to look at the scheme with a view to see whether it was one to which persons acting honestly and viewing the scheme in the interests of those they represent, took the view which can reasonably be taken by businessmen (*In Re. The Tata Iron & Steel Co., Ltd.,* (1928) 30 *Bom. L. R.* 197).

RESOLUTION

The resolution to be passed in connection with the change of the objects clause has, of course, to be in the form of a special resolution which has to be sanctioned by the Court. The resolution would run more or less as follows :—

RESOLVED :—That the provisions of the memorandum of association of the company with respect to the objects of the company be altered by adding the following words to sub-clause three of the said memorandum of association :—" And also to carry on the business of merchants, dealers, importers and exporters of cotton and coal and for that purpose to join as member of the Indian cotton association, coal merchants' association, or similar associations, societies or combinations formed for the furtherance or protection of the interests of cotton and coal trade in general.

(1) The alteration of the share-capital of a company is provided for by Section 50 of the Act as follows (that is to say) it may—

(*a*) increase its share-capital by the issue of new shares of such amount as it thinks expedient;

(*b*) consolidate and divide all or any of its share-capital into shares of larger amount than its existing shares;

(*c*) convert all or any of its paid-up shares into stock and reconvert that stock into paid-up shares of any denomination;

(*d*) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived;

(*e*) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share-capital by the amount of the shares so cancelled.

(2) The powers conferred by this section must be exercised *by the company in general meeting.*

(3) A cancellation of shares in pursuance of the section shall not be deemed to be a reduction of share-capital within the meaning of this Act.

(4) *The company shall file with the registrar notice of the exercise of any power referred to in clause (d) or clause (e) of sub-section (1) within fifteen days from the exercise thereof.*

Increase of Capital

Here the increase means the increase over the authorised capital of the company at the time when the resolution to increase such capital is to be passed. The Act does not make any specific provision as to how the increase is to be brought about, but infers that the same can be done subject to the provisions in the articles, which means that the resolution, either an ordinary, extraordinary or special, as may be provided for by the company's articles shall be passed. If the articles did not provide for any such contingency, the only course left open will be to alter the articles in the usual manner by passing a special resolution.

Unless this increase of capital is done by a proper resolution as laid down in the articles, the increase shall not be valid (*Bhimbhai* v. *Ishwardas*, (1894) 18 *Bom.* 152). The article can empower a company to increase its capital without an extraordinary or special resolution in which case an ordinary resolution is sufficient. A company can even confer on the directors the power to make the increase (*Mosely* v. *Koffyfontein Mines*, (1910) 2 *Ch.* 382). In a recent case where by the memorandum of association the company was empowered to issue a part of its capital with preferential rights and the articles did not give any express power to issue preference shares but the articles stated that shares were to be under the control of the directors and so was management of the business, it was held that the express power in the memorandum could be exercised (*Campbell* v. *Rofe*, (1933) *A. C.* 91). When the articles are said to be amended with a view to get the power to increase the capital, one special resolution amending the articles is sufficient if it authorises the issue of new shares (*Re. Bank of Hindustan, China and Japan, Campbells' Case*, (1873) 9 *Ch.* 1). It is further enacted

by Sec. 53 that within fifteen days after passing of the resolution for increase of the share-capital or after resolution authorising such increase, a notice shall be given to the registrar of joint stock companies. *This notice shall include particulars of the classes of share affected and the conditions (if any) subject to which the new shares are to be issued.* [53 (2)]. (The italics have been added by the amending act of 1936). The default in complying with requirements of this section entails a fine not exceeding Rs. 50 for each day during which the default continues, and every officer of the company who knowingly and wilfully authorises or permits such a default shall be liable for a like penalty. It may be added, however, that there is no objection to issuing shares at a premium, but in that case the premium should be carried to the credit of a separate reserve fund or any other account such as the "premium on shares account," and not mixed up with the capital. The clause in the Articles may run as follows :—

FORM OF ARTICLE EMPOWERING INCREASE OF CAPITAL

The company in general meeting may from time to time increase the capital by the creation of new shares of such amount as may be deemed expedient.

This will mean that the increase can be effected by an "ordinary resolution," but it is wiser to provide for a special resolution in which case words such as "by a special resolution" may be added in the article. It should be noted that now the Amending Act of 1936 by S. 50 (2) makes it compulsory that *powers conferred under the section of increasing consolidation etc., must be exercised now "by the company in general meeting."* This was done with a view to prevent companies delegating these powers to the board of directors through the articles of association as was done prior to this amendment of the Act.

With reference to the increase of capital where the articles do not give the necessary power, it has been held that the alteration of the articles, and authorising the increase, the two acts can, if necessary, be done by a single special resolution (*Campbell's Case*, (1873) 9 *Ch.* 1). This increase as we have seen can be made by the issue of new shares and these new shares may be preference shares or any other class of shares because according to *Andrews* v. *Gas Meter Co.*, (1897) 1 *Ch.* 361 the Court of Appeal has declared that unless the memorandum expressly states the rights of the different classes of shareholders the company can, by special resolution, obtain power with a view to issue preference shares. Of course the new shares cannot be issued at a discount either directly or indirectly as was attempted to be done in old days in England by pretending to be issuing shares at full value and allowing a large percentage of commission for subscribing these shares (*Ooregum Gold Mining Co.* v. *Roper*, (1892) *A. C.* 125). Here it was held that in winding up such shareholders who took shares under such conditions will have to pay up the balance unpaid to the benefit of other contributories as well as creditors. The issue of bonus shares also without a valuable consideration is objectionable on the same footing and those who receive such shares would be liable to pay the whole amount in cash (*Welton* v. *Saffery*, (1897) *A. C.* 299; *Re. Theatrical Trust*, (1895) 1 *Ch.* 771). It is also necessary that the notice convening the meeting to pass the resolution for increase of capital should specify the exact amount of the increase which is contemplated (*MacConnel* v. *Prill & Co., Ltd.*, (1916) 2 *Ch.* 57).

Frequently companies have articles which provide that in case of the issue of new shares with a view to increase the capital the said shares should be in the first instance offered to the existing members in proportion to their holdings as far as possible. These articles have to be strictly complied with and the Courts have restrained directors from contravening such a provision (*Gas Meter*

Co. v. *Diaphragm & General Leather Co.,* (1925) 41 *T. L. R.* 342). Of course in such cases the representatives of a deceased member would be entitled to the shares in the same proportion as the deceased was entitled (*James* v. *Buena Ventura,* (1896) 1 *Ch.* 456). When these shares are issued, generally speaking, the notice is accompanied by a letter of renunciation which enables the shares, or right to the shares, to be sold by the member entitled to them in case he does not want to buy the same. A form of letter of renunciation is given hereunder.

In one Indian case it was decided that if the resolution to increase the capital is not passed in accordance with the provisions of the articles, the increase shall not be valid (*Bhimbhai* v. *Ishwardas,* (1894) 18 *Bom.* 152). Of course the exact nature of power which a particular article according to construction confers on the directors has to be judged from the wording of the article itself (*Koffyfontein Mines* v. *Mosely,* (1911) *A. C.* 409). A company limited by guarantee may increase its share-capital in the same manner as a company limited by shares if authorised by its articles (S. 66).

FORMS OF RESOLUTIONS FOR INCREASE OF CAPITAL

Creation of New Ordinary Shares

RESOLVED:—That the capital of the company be increased to Rs. 5,00,000 by the creation of 100 additional ordinary shares of Rs. 1,000 each ranking for dividend in all other respects *pari passu* with the existing ordinary shares of the company.

NOTE:—If there is only one class of shares the word "ordinary" may be omitted.

Creation of New Preference Shares

RESOLVED:—That the capital of the company be increased from Rs. 4,00,000 to Rs. 5,00,000 by the creation of one hundred preference shares having the following special rights and privileges :—

(*a*) The rights to receive a fixed non-cumulative dividend in priority to ordinary shares of 7 per cent per annum.

(b) The right to rank as regards repayment of capital in priority to the ordinary shares in the event of the winding up of the company.

NOTE :—The following words may be added if appropriate:—"but without any further right to participate in the profits or assets of the company.

FORM OF LETTER OF RENUNCIATION AS APPROVED BY THE INSTITUTE OF BANKERS OF ENGLAND.

The All-India Prosperous Mining Company, Limited.

Authorised Capital Rs.   , divided into   **Shares**
of which shares have been issued and are fully paid up.

FURTHER ISSUE OF   SHARES OF Rs.   EACH.
At Par
At a Premium of   per Shares.

102, Esplanade Road,
Bombay,...............19......

To the SHAREHOLDER whose name and address are written in the bordered space on the Reverse of this Letter.

Sir (or Madam),

With reference to our circular of this date, your present holding and the extent of your right to participate in the above-mentioned issue are specified on the reverse of this letter, opposite your name.

If you intend to take up the shares to which you are entitled you will please fill up and sign the Form of Acceptance and forward the *entire* sheet, with the necessary remittance, to the Company's Bankers the *Bank of India, Limited,* 82, *Esplanade Road, Bombay* to be received by them *not later than........day of......19....*

If you desire to transfer your rights you must sign the "Form of Renunciation and Nomination," as set out on the reverse of this letter, and your Nominee(s), who must be of full age, must (instead of you) then fill up and sign the Acceptance Form and forward the *entire* sheet with the necessary remittance *as directed in the preceding paragraph.*

Should you elect to divide your rights, the *entire* Form must be deposited at the company's office to be cancelled and exchanged for Split Forms.

If the Conditions as to acceptance and payment are not duly observed,your right to participate in the above mentioned issue will

be absolutely forfeited and the directors will deal with the Shares for the benefit of the company at their discretion.

Yours faithfully,

Secretary.

.... (Perforation) ....

A share certificate in the name of the acceptor will be ready on ; it will be exchanged on or after that date at the company's office, 102, Esplanade Road, in exchange for this receipt.

BACK OF THE ABOVE FORM.

The All-India Prosperous Mining Company, Limited

Space for Name and Address of Shareholder, to be filled in by the Company	No............. Present holding............Shares Entitled to a *pro rata* allotment of........Shares Joint Shareholders.................. (if any) .... Names only........................

FORM OF RENUNCIATION AND NOMINATION, TO BE SIGNED BY THE SHAREHOLDER ONLY IF THE RIGHTS ARE RENOUNCED

To the Directors of the All-India Prosperous Mining Co., Ltd.

Name (in full) Address and Occupation of Nominee. (If lady, state whether spinster, wife or widow).	I/We hereby renounce my/our right to the above-mentioned new Shares and nominate. .... to have all the benefits of the offer contained in your Circular dated

(Signature of Shareholder) *..................

Date............19......

Affix

Stamp.

* Instructions as to signatures of joint holders.

FORM OF ACCEPTANCE TO BE SIGNED BY THE SHARE-HOLDER OR NOMINEE

To the Directors of the All-India Prosperous Mining Company, Ltd.

Having paid to your Bankers the sum of Rs.........being the First Instalment at the rate of.........per Share in respect of........shares referred to in the within letter, I/we the above-mentioned shareholder(s)/nominee(s) hereby accept your offer of the said shares pursuant to the memorandum and articles of association of the company and subject to the terms and conditions of your circular of.............and I/we authorise you to place my/our name(s) on the Register of Members in respect of the said shares.

(Signature of Acceptor)*..
....
....

Date..........19....

Cheques should be made payable to BEARER and crossed NOT NEGOTIABLE

If altered from "order" to "bearer" the alteration should be *signed by the drawer.*

The acceptor is particularly requested to write clearly, within the bordered space below, his or her name, and the *full* address to which the receipt should be sent. For joint accounts the first name should be written within, and the other or others below, the bordered space.

.... (Perforation) ....

The All-India Prosperous Mining Company, Limited

Further Issue of Shares of Rs. each at No......

<table>
<tr><td>Name of First or of Sole Acceptor.</td><td>..................
..................</td><td rowspan="2">Received for Account of the All-India Prosperous Mining Co., Ltd., from the person(s) whose name(s) is/are written in the margin the undermentioned amount being the First Instalment at the rate of per Share, payable on Acceptance of Shares of above-mentioned Issue.
For BANK OF INDIA LTD.,
....
Cashier.</td></tr>
<tr><td>Address</td><td>..................
..................</td></tr>
<tr><td>Joint Acceptors, if any.
Names only</td><td>..................
..................</td><td>Rs........ ....19 .</td></tr>
</table>

* Instructions as to signatures of joint Acceptors.

FORM OF NOTICE OF MEETING TO INCREASE CAPITAL

Form of notice of Extraordinary General Meeting called with a view to pass an ordinary resolution in order to increase the share-capital of a company by issuing of new preference shares.

THE ALL-INDIA PROSPEROUS MINING COMPANY, LIMITED

Notice is hereby given that an extraordinary general meeting of the above company will be held at the Central Hall Building, Esplanade Road, Bombay, on Friday, 21st April, 1937, at 5 P.M. when the sub-joined resolution will be submitted in the meeting to be passed as ordinary resolution :—

> "That the capital of the Company be increased from Rs. 10,00,000 to Rs. 12,00,000 by issuing 200 Preference Shares of Rs. 1,000 each and that the said Preference Shares shall confer the following rights with respect to capital and dividends, *viz.*, (1) the right to a cumulative preference dividend at the rate of Rs. 8% per annum on the paid up capital on the said shares which shall rank in priority to any dividend on the existing capital of the Company, and (2) the said preference shares shall have a right on winding up to a repayment of the capital paid up thereon in priority to any payment in respect of the other shares in the existing capital of the company."

NOTE :—In case the above resolution has to be passed as an extra-ordinary or special resolution the notice should state that fact clearly.

Form of notice to the registrar of joint stock companies with respect to the increase of a nominal capital would be more or less in the following form :—

FORM OF NOTICE TO REGISTRAR OF INCREASE IN CAPITAL

NOTICE

of

THE INCREASE OF THE NOMINAL CAPITAL

ot

The........................Company, Limited.

(Pursuant to Section 53 of the Indian Companies Act, 1913)

Presented for filing by :

Signature.............................

Designation.............................

To

The Registrar of Joint Stock Companies.

The above named company hereby gives you notice, in accordance with S. 53 of the Indian Companies Act, 1913, that by a special resolution of the company passed on the...........day of.........19...and confirmed on the........day of.........19... the nominal capital of the company has been increased by the addition thereto the sum of Rupees..........divided into................shares of..........rupees each, beyond the present registered capital of Rupees.

Dated, Signature.........................

The............19...... Designation.......................

FORM OF ARTICLES USED BY INDIAN COMPANIES GIVING POWERS TO DIRECTORS AS TO THE INCREASE OF CAPITAL

1. The board of directors may, with the sanction of a special resolution from time to time increase the capital of the company to any amount by the creation of new shares, as they may deem expedient. The new shares shall be issued upon such terms and conditions and with such rights and privileges annexed thereto, as the board resolving upon the creation thereof shall direct, and in particular, such shares may be issued with a preferential or qualified right to dividends, and in the distribution of assets of the company, and with a special or without any right of voting and the board resolving upon the creation of the shares may direct that the same or any of them be offered in the first instance to all the then members, in proportion to the amount of capital held by them, or make any other provisions as to the

issue and allotment of the new shares. The company may also exercise any of the powers conferred by Section 50 of the said Act.

2. Except so far as otherwise provided by the conditions of issue or by these presents, any capital raised by the creation of new shares, shall be considered as part of the initial capital and shall be subject to the provisions herein contained, with reference to the payments of calls and instalments, transfer and transmission, forfeiture, lien, surrender, voting and otherwise.

An alternative set of articles run as follows :—

1. The company may from time to time by special resolution increase its capital by the creation of new shares of such amount as may be deemed expedient. The new shares shall be issued upon such terms and conditions and with such rights and privileges annexed thereto, as the general meeting resolving upon the creation thereof shall direct, and if no direction be given, as the directors shall determine; and in particular such shares may be issued with a preferential or qualified right to dividends and in the distribution of assets of the company, and with a special or without any right of voting: provided always that notwithstanding anything in this clause contained, the rights or privileges attached to the preference shares in the capital for the time being of the company shall not be modified, except in manner hereinafter provided.
2. The company may by special resolution, before the issue of any new shares, determine that the same, or any of them, shall be offered in the first instance to all the then members in proportion to the amount of the capital held by them, or make any other provisions as to the issue and allotment of the new shares, but in default of any such determination, or so far as the same shall not extend, the new shares may be dealt with as if they formed part of the shares in the initial capital.
3. Except so far as otherwise provided by the conditions of issue or by these presents, any capital, raised by the creation of new shares, shall be considered part of the initial capital, and shall be subject to the provisions herein contained, with reference to the payment of calls and instalments, transfer and transmission, forfeiture, lien, surrender, voting and otherwise.

A further alternative set of articles are as follows :—

1. The board may, with the sanction of a special resolution previously passed, increase the capital of the company to any amount specified in such resolution by the issue of new shares, preference or otherwise, of such respective amount and value as may be specified in such resolution.
2. Subject to any direction to the contrary that may be given by the meeting that sanctions an increase of capital, all new shares of whatever kind shall be offered to the members in proportion to the existing shares held by them; and such offer shall be made by notice specifying the number of shares to which the member is entitled, and limiting a time within which the offer, if not accepted, will be deemed to be declined, and after the expiration of such time, or on the receipt of an intimation from the member to whom such notice is given that he declines to accept the shares offered, the directors may dispose of the same in such manner as they think most beneficial to the company.
3. Whenever an increase or decrease of capital or division of shares may have been sanctioned in manner aforesaid, the board shall carry the sanctioning resolution into effect, in such manner as they may deem most expedient, subject nevertheless to these presents, and to the legislative provisions for the time being in force in that behalf, and to the special directions (if any) given in reference thereto by the general meeting at which such sanctioning resolution may have been passed.
4. Any capital so created shall, except so far as is otherwise directed by any such special direction as aforesaid, be subject to these presents, in the same manner as if it had been part of the original capital.

The form of the article where the issue of new shares to the existing members is to be at the option of the directors of the company :—

Unless otherwise determined by the directors or by the resolution authorising an increase of capital, any original shares for the time being unissued, and any new shares from time to time to be created, shall, before they are issued, be offered to the members in proportion, as nearly as may be, to the number of shares held by them. Such offer shall be made by notice specifying

the number of shares offered, and limiting a time within which the offer, if not accepted, will be deemed to be declined, and after the expiration of such time, or on the receipt of an intimation from the person to whom the offer is made that he declines to accept the shares offered, the directors may, subject to these articles, dispose of the same in such manner as they think most beneficial to the company. The directors may, in like manner, dispose of any such new or original shares as aforesaid which, by reason of the proportion borne by them to the number of persons entitled to such offer as aforesaid or by reason of any other difficulty in apportioning the same, cannot in the opinion of the directors be conveniently offered in manner hereinbefore provided.

An alternative article to the above is as follows :—

The company may, before the issue of any new shares, determine that the same, or any of them, shall be offered in the first instance, and either at par or at a premium, to all the then members or any class thereof, in proportion to the amount of the capital held by them, or make any other provisions as to the issue and allotment of the new shares; but in default of any such determination, or so far as the same shall not extend the new shares may be dealt with as if they formed part of the shares in the original ordinary capital.

Consolidation or Conversion of Share-Capital

Here also this consolidation and conversion can only be effected if the articles so authorise and in the manner provided for by the articles. (S. 50(1) b). The remarks in connection with the increase of share-capital apply as far as the clause in the articles not being there is concerned, but assuming that the clause is there, consolidation or conversion can be effected by a resolution as provided for by the articles. Notice of both conversion and consolidation must be given within fifteen days of effecting the same, to the registrar of joint stock companies as provided for in the case of increase of capital with like penalties, and every copy of the memorandum should be in conformity with consolidation or conversion after the date of the alteration.

In this connection the other relevant and important section is Sec. 54. This section runs as follows :—

54. (1) A company limited by shares may, by special resolution confirmed by an order of the Court, modify the conditions contained in its memorandum so as to reorganise its share-capital, whether by the consolidation of shares of different classes or by the division of its shares into shares of different classes :

Provided that no preference or special privilege attached to or belonging to any class of shares shall be interfered with except by resolution passed by a majority in number of shareholders of that class holding three-fourths of the share-capital of that class and every resolution so passed shall bind all shareholders of the class.

(2) Where an order is made under this section, a certified copy thereof shall be filed with the Registrar within twenty-one days after the making of the order, or within such further time as the Court may allow, and the resolution shall not take effect until such a copy has been so field.

The above section deals with the question of reorganisation of the company's share-capital, which reorganisation may include consolidation of different shares of different classes or by the division of its shares into shares of different classes. Here the company can bring about either of these acts if it is a company limited by shares by first passing a special resolution and getting it confirmed by an order of the Court. This is, of course, a section which affords a different form of consolidation and sub-division than the one which Sec. 50 lays down. A company limited by guarantee having a share-capital registered since 1st April, 1914, has power to consolidate its shares. Sec. 54 limits the general power which otherwise Sec. 153 gives by which under the latter section a company can make arrangements with its members affecting their shares and rights which may include that of consolidation and division. Sec. 54 aims at modification of the conditions in memorandum either by consolidation of shares of different classes or by division of shares into shares of different classes. Sec. 153 does not apply in

cases where there is a mere increase of the number of shares of a class and no consolidation of shares of, or division of shares into different classes in contemplation (*Re. Schweppes Ltd.*, (1914) 1 *Ch.* 322). This section also does not apply in cases where the preferential rights are conferred by articles only and the reorganisation does not involve any modification of the conditions of the memorandum (*Re. Australian Estate & Mortgage Co. Ltd.*, (1910) 1 *Ch.* 414). It will be seen from the proviso in Sec. 54 that where this reorganisation affects any special rights of any class of shares conferred by the memorandum and involves consolidation or sub-division, not only a special resolution of the company is required, but a resolution of a separate meeting of that class of shareholders who are affected must be passed by a majority in number of that class holding at least three-fourths of the share-capital of that class and confirmed by a special resolution. In these cases voting by proxy is allowed where such proxies are allowed by the articles (*Re. Foucar & Co., Ltd.*, (1913) 29 *T. L. R.* 350). Of course this resolution has to be confirmed by the Court and a certified copy has to be filed with the registrar. In one case where only one shareholder held all the preference shares it was held that his consent to the modified rights of preference shareholders was equivalent to a resolution passed at a meeting of the preference shareholders on a true construction of the memorandum and articles of the company (*East* v. *Bennet Bros. Ltd.*, (1911) 1 *Ch.* 163). An application to the Court for confirmation of this resolution has to be made by petition and it is not necessary to advertise same (*Re. Ashanti Development, Ltd.*, (1911) 27 *T. L. R.* 498). The time allowed for the filing of the certified copy of the order with the registrar is twenty-one days after the making of the order or within such further time as the Court may allow [S. 54 (2)]. In one case while acting under Sec. 54 (corresponding Sec. 45 of English Act of 1908) where the nominal capital of the company was £55,000 fully paid they attempted to reorganise so as to rearrange the shares,

with the result that though the nominal capital was left at £55,000 the paid-up capital was actually reduced to £40,000. This was objected to on the ground that the proposal was in fact a reduction and therefore should not be granted. The Court granted the prayer and confirmed the resolution (*Peebles Hotel Hydropathis, Ltd.*, (1920) *S. C.* 303). The difference between the position created by the utility of Sec. 54 as compared with Sec. 153 is that the former section (S. 54) gives inferentially a power to modify preferential rights created by the articles of association, with the result that powers given by the memorandum to preferential or any class of shareholders cannot be altered, or interfered with, except upon the conditions laid down in Sec. 54 and on following the procedure as given there. Sec. 153 on the other hand does not give any express authority to alter capital or interfere with preferential rights (*Re. Doecham Gloves, Ltd.*, (1913) 1 *Ch.* 226). It should be also noted that Sec. 54 is not an enabling section but it is a section which limits general powers to make arrangements under Sec. 153. Under Sec. 54, as we have already seen consolidation and sub-division has only to be dealt with, whereas in other cases where a scheme of arrangement is so framed that it interferes with the rights conferred by the memorandum a compliance with Sec. 153 is sufficient (*Re. Nordberg, Ltd.*, (1915) 2 *Ch.* 439). A company which had capital divided into ordinary and preference shares, resolved in connection with certain unissued preference shares to convert them into ordinary shares and to attach to the preference shares a right to participate *pari passu* with the ordinary shares in the surplus profits. To give effect to this, resolutions were passed and confirmed, both at the general meeting of the company and at the special meeting of preference shareholders. A separate meeting of ordinary shareholders was not held, but in spite of that the Court confirmed the special resolution on the ground that it was unnecessary that ordinary shareholders' separate meeting should be held (*Re. Stewart Precision Carburettor Co.*, (1912) 23 *T. L. R.* 335).

Forms of articles *re.* consolidation and sub-division of shares are as follows :—

The company may from time to time by special resolution sub-divide or consolidate its shares, or any of them, and the special resolution whereby any share is sub-divided or any shares are consolidated, may determine that, as between the holders of the shares resulting from such sub-division or consolidation, one or more of such shares shall have some preference or special advantage as regards dividend, capital, voting or otherwise over or as compared with the others or other.

An alternative form is as follows :—

1. The company may also, by special resolution, sub-divide or, by ordinary resolution, consolidate its shares or any of them.
2. The special resolution whereby any share is sub-divided may determine that, as between the holders of the shares resulting from such sub-division, one or more of such shares shall have same preference or special advantage as regards dividend, capital, voting, or otherwise over or as compared with the others or other.

Another alternative form is as follows :—

The company alter the conditions of the memorandum by ordinary resolution as follows :—

(*a*) consolidate and divide all or any of its share-capital into shares of larger amounts than its existing shares.

(*b*) cancel shares which at the date of the passing of such ordinary resolution have not been taken or agreed to be taken by any person and diminish the amount of its share-capital by the amount of the shares so cancelled.

and by special resolution

(*c*) sub-divide its shares or any of them into shares of smaller amounts than are fixed by the memorandum, subject nevertheless to the provisions of the Act in that behalf and so that as between the holders of the shares resulting from such sub-division, one or more of such shares may be given any preference or advantage as regards dividend, capital voting or otherwise over the others or any other of such shares.

Form of articles with reference to modification of rights of shareholders is as follows :—

Whenever the capital, by reason of the issue of preference shares or otherwise, is divided into different classes of share, all or any of the rights and privileges attached to each class may be modified, commuted, affected, abrogated, or dealt with by agreement between the company and any person purporting to contract on behalf of that class, provided such agreement is ratified in writing by the holders of at least three-fourths in nominal value of the issued shares of the class, or is confirmed by an extraordinary resolution passed at a separate general meeting of the holders of shares of that class and all the provisions hereinafter contained as to general meetings, shall *mutatis mutandis,* apply to every such meeting, but so that the quorum thereof shall be members holding, or representing by proxy one-fifth of the nominal amount of the issued shares of the class. This clause is not to derogate from any power the company would have had if this clause were omitted.

The alternative form is as follows :—

Whenever the capital, by reason of the issue of preference shares or otherwise, is divided into different classes of shares, all or any of the right and privileges attached to the different classes of shares in the capital for the time being of the company, may be modified, commuted, affected, or abrogated, by agreement between the company and any person purporting to contract on behalf of that class, provided such agreement is confirmed by an extraordinary resolution passed at a separate general meeting of the holders of the shares of that class, and all the provisions hereinafter contained as to general meetings shall, *mutatis mutandis,* apply to every such meeting, but so that the quorum thereof shall be members holding or representing in person or by proxy one-fifth of the nominal amount of the issued shares of the class. This article is not to derogate from any powers the company would have if it were omitted.

FORMS OF RESOLUTIONS AS TO CONSOLIDATION OF SHARE

Simple Consolidation

RESOLVED :—That the existing share-capital of the company of 7,000 shares of Rs. 500 each fully paid in the capital of this

company be consolidated in such manner that every two of the existing two shares of Rs. 500 each shall constitute one share of Rs. 1,000 each fully paid and that existing certificates be called in and cancelled and in lieu thereof new certificates be issued.

Consolidation of Two Classes of Shares into One

RESOLVED :—That the capital of the company be reorganised and consolidated by amalgamating the present 1,000 fully paid ordinary shares of Rs. 500 each with the fully paid 1,000 preference shares of Rs. 500 each into one single class of ordinary shares of Rs. 1,000 each fully paid, ranking *pari passu* in all respects as well as with regard to dividends and that the memorandum of association be altered accordingly.

Sub-division of Shares

Here a similar rule is provided by sub-clause (*d*) of S. 50 under which a company can sub-divide its shares into shares of smaller amount, the only condition being that the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived. Here it may be stated that S. 55 lays down that if a reorganisation of share-capital is to be made, the Court may, in sanctioning a sub-division, allow such adjustment to be made as where the amount unpaid may not be equally divided between the resulting shares (*In re. Doloswella Rubber & Tea Estates, Limited,* (1917) 1 *Ch.* 213). In this case the issued share-capital of the company consisted of 640 shares of £500 each on which £185 per share had been called up and paid. The Court under S. 46 (*a*) of the English Companies Consolidation Act of 1908, which corresponds to S. 55 (1) (*a*) of our Act, sanctioned a special resolution reducing this capital by (*a*) dividing each issued share of £500 into five shares of £100 each; (*b*) apportioning the £185 called up on each issued £500 share equally between three of the £100 shares resulting from such sub-divisions leaving a liability of £38-6-8 on each of such three £100 shares, and (*c*) surrendering for reissue when

required the remaining wholly unpaid two shares of £100 each.

The rule as to making the memorandum of association accord with the resolution as soon as the sub-division is effected has to be observed in this case as in all former cases, and a copy of such resolution also has to be filed with the registrar within 15 days of the date of confirmation as provided for by S. 52.

Forms of Resolutions as to Sub-division in case of Fully Paid Shares

RESOLVED :—That the existing 1,000 shares of Rs. 1,000 each in the capital of this company issued and fully paid-up be divided into 2,000 fully paid shares of Rs. 500 each.

In Case of Partly Paid Shares

RESOLVED :—That existing 1,000 shares of Rs. 1,000 each in the capital of this company with Rs. 600 on each share paid-up be divided into 10,000 shares of Rs. 100 each upon each of which a sum of Rs. 60 shall be credited as paid-up.

Cancellation

In connection with cancellation, a company limited by shares is permitted by sub-clause (*e*) of S. 50 (1) to do so if so authorised by its articles. These shares are those which at the date of the passing of the resolution have not been taken up or agreed to be taken up by any person and thereby diminish the amount of shares so cancelled. This power is in addition to the power which is specifically given by S. 55 for reduction, because in case of this cancellation, the confirmation of the Court is not necessary, but the company can act of its own accord in accordance with the provisions of its articles. This cancellation is not, in fact, a reduction of share-capital under Sec. 55 and thus this power is in addition to the power given by Sec. 55. All other shares cannot be cancelled but can only be reduced under the procedure laid down for reduction (*Sorabji* v. *Ishwardas,* (1896) 20 *Bom.* 654; *Bhimbhai* v. *Ishwardas,* (1894) 18 *Bom.* 152).

Forms of Resolution as to Cancellation of Unissued Shares

RESOLVED :—That the nominal capital of the company be reduced from Rs. 5,00,000 to Rs. 4,00,000 by cancellation of 100 shares of Rs. 1,000 each which have not been issued. (Or which have not been taken up or agreed to be taken up by any person).

Reduction of Capital

With reference to the reduction of capital S. 55 (1) expressly lays down that in case a company limited by shares takes any action which involves the reduction of the liability of the shares issued or paid-up, this reduction shall only be made in the following three cases subject to the confirmation of the Court, if authorised by its articles, by a special resolution :—

(*a*) To extinguish or reduce the liability on any of the shares, in respect of share-capital not paid-up; or

(*b*) Either with or without extinguishing or reducing liability on any of its shares, cancel any paid-up share-capital which is lost or unrepresented by available assets; or

(*c*) Either with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share-capital which is in excess of the wants of the company, and may, if and so far as is necessary, alter its Memorandum by reducing the amount of its share-capital and of its shares accordingly.

The provision in S. 55 (1) (*c*) also applies to capital which can only be called up in case of a liquidator (*Midland Railway Carriage Company*, (1907) *W. N.* 175). The resolution under Section 55 may provide for the return of capital on the footing that the amount so returned or any part thereof may be again called up (*In re. Brown Sons & Co.*, (1931) *Crt. of Sess. S. C.* 701). When deferred shares were reduced and converted into ordinary shares the scheme was approved though opposed because the articles gave power to reduce by "paying off or cancelling lost capital, reducing liability on shares or otherwise as may seem expedient. In this case it was also held that presence of other class of shareholders at a class meeting did not

invalidate proceedings as they did not vote either by show of hands or at the poll (*In Re. Imperial Chemical Industries Ltd.,* (1936) 1 *Ch. D.* 587).

It is further provided that this special resolution under this Section is to be called a "resolution of reduction of the share-capital." It may incidentally be added that S. 54A also provides that no company limited by shares shall have power to buy its own shares *or the shares of a public company of which it is a subsidiary company* unless the consequent reduction of capital is effected and sanctioned in the manner provided by Ss. 55 to 66. This last provision is only a codification of the principal enunciated in two leading cases by the House of Lords, *viz.,* (1) *Trevor* v. *Whitworth,* (1887) 12 *A. C.* 409; and (2) *British and American Trustee Corporation* v. *Couper,* (1894) *A. C.* 399). The point to be remembered in connection with reduction is that any arrangement concerning the company's capital, which has the effect of reducing the capital, is invalid unless and until it is confirmed by the Court (*Bhimbhai* v. *Ishwardas,* (1894) 18 *Bom.* 152). The principle on which the Court acts in connection with reduction of capital is to see that (1) the creditors are not prejudiced; and (2) that the reduction is fair and equitable to the members and as between the different classes of members (*Poole* v. *National Bank of China, Ltd.,* (1907) *A. C.* 229). It will also be noticed that the section requires that there must be a power in the articles to reduce and therefore it has been held that if the power in memorandum only is taken it is ineffective (*Re. Dexine Patent Packing & Rubber Co.,* (1903) 88 *L. T.* 791). In case the articles do not give this power it is quite open to the company to take that power by altering the articles and in a subsequent meeting by another special resolution authorise the reduction (*Re. Patent Invert Sugar Co.,* (1885) 31 *Ch. D.* 166). As we have already seen here under Sec. 55 the reduction of capital is quite apart and distinct from the cancellation of capital as dealt with in connection with Sec. 50. In connection with this section we have to con-

sider the reduction of issued capital. Of course there is no objection to combine the reduction of unissued capital with that of issued capital, and issued capital may be reduced whether fully paid-up or not (*Re. Anglo-French Exploration Co.,* (1902) 2 *Ch.* 845). We have known one more method of reducing capital, *viz.,* by forfeiture of shares for non-payment of calls or surrender of shares under the special powers reserved in the articles. In case of an unlimited company also it can provide by its memorandum and articles for a return of capital to its members (*Re. Borough Commercial and Building Society,* (1893) 2 *Ch.* 242). The question that the Court has to decide when an application for reduction is made is whether the reduction is fair and equitable as between different classes of shareholders and whether the Court ought to refuse its sanction to the reduction out of regard to the interests of those members of the public who may be induced to take shares in the company, in this case the creditors not being concerned in the question (*Poole* v. *National Bank of China, Ltd.,* (1907) *A. C.* 229, see remarks of *Lord Macnaghten* on page 239, para 2). Where a reduction works unjustly on the minority it will be disallowed (*Barrow Haematite S. Co., No.* 2, (1900) 2 *Ch.* 846). Where founders' shares were sought to be extinguished and a larger number of ordinary shares were proposed to be issued the scheme was disallowed as it amounted to issue at a discount (*Development Co. of Central and West Africa,* (1902) 1 *Ch.* 547). This reduction of capital may be effected in any manner provided the sanction of the Court is obtained and any other course in order to bring about this reduction without such sanction is entirely forbidden, such as the purchase of the company's shares by the company itself or of the rights of members or a sub-division of shares in which the amount unpaid is not equally divided between the resulting shares (*British and American Trustee and Finance Corporation* v. *Couper,* (1894) *A. C.* 399; *Doloswella Rubber Estates,* (1917) 1 *Ch.* 213). This reduction may be effected not only where

capital sought to be written off is lost or is unrepresented by realisable assets, but also where there is no loss of capital or where there is a substantial reserve fund created out of the undivided profits (*Caldwell* v. *Caldwell & Co.*, (1915) *W. N.* 70; *Poole* v. *National Bank of China*, (1907) *A. C.* 229). A company having power under its articles to reduce capital by paying off, cancelling lost capital, reducing the liability on its shares "or otherwise as may seem expedient" was entitled to reduce its capital in any manner authorised by statute (*In re. Imperial Chemical Industries, Ltd.*, (1936) 1 *Ch. D.* 58). In the same case it was also held that the presence of the shareholders of other class at a class meeting of shareholders of a class did not invalidate the proceedings as others were not voting at it; and that the directors were not bound to disclose their holdings to the shareholders in their circulars explaining the scheme of reduction. Reduction of course takes effect only on registration of the minutes as required by the Act (S. 61). There is the important question as to the rights of class shareholders where the company's capital is divided into preference and ordinary shares and a reduction is sought to be effected. Here there would be no objection to proportionately reduce both preference and ordinary shares though the preference shareholders under such circumstances may get a reduced dividend (*Bannatyne* v. *Direct Spanish Telegraph Co.*, (1887) 34 *Ch. D.* 287; *Mackenzie & Co.*, (1916) 2 *Ch.* 450). If however the preference shares carry preferential rights not only on dividends but also in connection with the distribution of capital in liquidation it was held that the reduction should be made upon ordinary and deferred shares alone (*Quebrada Copper Co.*, (1889) 40 *Ch. D.* 363). Where the rights of various classes of shareholders can be varied under powers given in the articles, the reduction of capital is sanctioned in a proper way although it may affect the voting powers of the respective classes of shareholders (*Re. James Colmer*, (1897) 1 *Ch.* 524). The company's capital may be divided into ordinary and preference shares and then the reduction

may equally reduce both these classes of shares although the resulting effect will be to give the preference shareholders a lower rate of dividend (*Bannatyne* v. *Direct Spanish Telegraphic Co.*, (1887) 34 *Ch. D.* 287; *Mackenzie & Co.*, (1916) 2 *Ch.* 450). However, where preference shares carry preferential rights as to distribution of capital in liquidation also the best course is to reduce ordinary and deferred shares only (*Quebrada Copper Co.*, (1889) 40 *Ch. D.* 363). Otherwise equal proportion would have to be reduced unless the ordinary shareholders understand and assent to the scheme (*Floating Dock Co., of St. Thomas*, (1895) 1 *Ch.* 691; *Poole* v. *National Bank of China*, (1907) *A. C.* 229; see also *The Union Plate Glass Co.*, (1889) 42 *Ch. D.* 516; *Barrow Haematite Steel Co., No.* 2, (1900) 2 *Ch.* 846 *and* (1901) 2 *Ch.* 746). According to Sec. 57 in order to effect reduction a resolution should be passed by the company and *on and from the making of the order confirming the reduction the company must* add to its name until such date as the Court may fix the words "and reduced" as the last words in its name and those words shall, until that date, be deemed to be part of the name of the company provided of course where the reduction does not involve either the diminution of any liability in respect of unpaid share-capital or the payment to any shareholder of any paid-up share-capital, the Court may, if it thinks expedient, dispense altogether with the addition of the words "and reduced" (S. 57). The usual procedure laid down is that where the proposed reduction involves diminution of liability in respect of unpaid share or the payment to any shareholder of any paid-up share-capital or in any other case if the Court so directs every creditor of the company who at the date fixed by the Court is entitled to any debt or claim which debt if that debt was at the commencement of the winding up of the company would be admissible in proof against the company shall be entitled to object to the reduction (S. 58). In these cases the Court settles the list of creditors who are thus entitled to object and for that purpose shall

ascertain as far as possible without requiring an application from any creditor the names of those creditors and the nature and amount of their debts or claims. The Court may publish notices fixing the day or days within which the creditors not entered on the list are to claim to be so entered or are to be excluded from the right of objecting to the reduction. If any of these creditors does not consent to the reduction, the Court may dispense with the consent of the creditor on the company securing payment of his debt or claim by appropriating as the Court may direct such amount if any that the company admits or though not admitting same is willing to provide for it. If the company does not admit or is not willing to provide for the full amount of the debt or claim or the amount is contingent or not ascertained, then an amount may be fixed by the Court after the necessary enquiry and adjudication as if the company was being wound up by the Court (S. 59). After ascertaining that every creditor who was entitled to object has either given his consent to the reduction or his claim has been discharged or has been determined or secured, the Court may make an order confirming the reduction on such terms and conditions as it deems fit (S. 60). In connection with the obtaining if consent of creditors and securing the dissentient creditors in one case where names of the holders of debentures to bearer could not be ascertained the Court allowed the unanimous resolution of a meeting of debenture-holders representing eighty-seven per cent to be reckoned as equivalent to the consent of all (*Hydraulic Power & Smelting Co.*, (1914) 2 *Ch.* 187). It may be added that even in case of capital represented by fully-paid stock reduction can be allowed on the footing of say every one pound of stock reduced for every so many shilling of stock as may be desired (*House Property & Investment Co.*, (1912) 56 *S. J.* 505). Section 61 then makes compulsory the registration of the order of the Court confirming the reduction with the registrar of joint stock companies and the notice of the registration

has to be published in such manner as the Court may direct. The Court also adds that the order shall take effect on registration and not before. The registrar has to certify this registration of the order and minute and his certificate is conclusive evidence that all the requirements of the Companies Act respecting the reduction of the share-capital have been complied with and that the share-capital of the company is such as is stated in the minute. The minute when registered will be deemed to be substitute for the corresponding part of the memorandum of the company and is valid and unalterable as if it has been originally contained therein. This minute shall also be embodied in other copies of the memorandum issued after its registration. Non-compliance or default entails a fine not exceeding Rs. 10 for each copy in respect of which the default is made, and the officers of the company who knowingly or wilfully authorise or permit the default shall be liable to the like penalty (S. 62). In one case while the Court confirmed the scheme as on the whole fair and equitable it made a term of its confirmation that the cost of a dissentient shareholder while assisting the Court by his criticism of the scheme should be provided for by the company (*Re. De La Rue Thomas & Co., Ltd.,* (1911) 2 *Ch.* 361). The Court can even reduce some of a particular class of shares without altering or reducing others of the same class (*Union Plate Glass Co.,* (1889) 42 *Ch. D.* 516; *Pinkney & Sons Steamship,* (1892) 3 *Ch.* 125). It can also sanction an alteration or reduction in a proper case which involves the voting rights of the shareholders (*Continental Union Gas,* (1891) 7 *T. L. R.* 476). In another case a reduction of capital was attempted to be made by a resolution authorising both the past payments made out of profits as well as payments to be made in future to be treated as return of capital it was held that the resolution was void in so-far as it had a retrospective or prospective effect (*Re. Piercy In Whitwham* v. *Piercy,* (1907) 1 *Ch.* 289; 95 *L. T.* 868). The question of reduction of capital

is usually a question of compromise between the interested parties and in case in a compromise the preference shareholders agree by a sufficient majority to forego the arrears of cumulative dividends the arrangement is not *ultra vires* (*Oban and Aultmore Glenlivat Distillery*, (1904) *Crt. of Sess.* 5 *F.* 1141). In another case an attempt was made to pay out from the accumulated profits of certain amount by way of reduction of capital to the holders of ordinary shares of the company who were fully paid, and not to the residue who were not fully paid, it was held that the section could not be construed as only authorising the return of capital to the whole class of shareholders among whom the accumulated profits were divisible and therefore the resolution was not *ultra vires* (*Neale* v. *City of Birmingham Tramways Co.*, (1910) 2 *Ch.* 464). As far as the reduction of the capital is concerned if there is no power in the articles, the special resolutions altering the articles should be passed at one meeting and at the next subsequent meeting another special resolution as to reduction to be effective has to be passed, but the same cannot be done here by one and the same special resolution (*Re. Patent Invert Sugar Co.*, (1886) 31 *Ch. D.* 166). It has been held that when a petition is made for the reduction of the capital of a company by paying off excess capital it must be stated that the capital proposed to be paid off is in excess of the wants of the company (*Re. Tarapaca & Tocapilla Nitrate Co., Ltd.*, (1917) 62 *Sol. J.* 122). In one case where the Court was petitioned for reduction of capital with a view of cancelling of capital which was lost or was unrepresented, it has been held that the list of creditors of or class certificate of creditors on the order of petition must be advertised (*Re. London and Canada Plate Glass Insurance Co., Ltd.*, (1885) 55 *L. T.* 486). But in case of a reduction which involved the diminution of liability in respect of unpaid capital and the return of paid-up capital to shareholders even where the company had no debts unsatisfied, the Court held that it could not dispense with the settling of the list of creditors

according to the procedure laid down by the Act (*Re. Lamson Store Service Co., Ltd.; Re. National Reversionary Investment Co., Ltd.,* (1895) 2 *Ch.* 726). Under Sec. 55 of our Act a special resolution was passed returning a part of the amount of each share to be again called up if necessary, which was held to be competent under the Section (*In Re. Brown Sons & Co.,* (1931) *S. C.* 701). Where the creditors on the list are residing abroad the company may get the order of reduction passed by bringing into the Court the amounts of such creditors demands as appearing on the list and giving them notice of their having done so (*Re. West India and Pacific Steamship Co.,* (1868) 19 *L. T.* 310). Where a reduction is effected simultaneously with sub-division the minute should state the facts as to sub-division but it is not compulsory that it should contain the numbers of original shares (*Re. London and Rhodesian Mining and Land Co., Ltd.,* (1919) 36 *T. L. R.* 87). Notwithstanding that the company is in course of winding up, a scheme for reduction or reorganisation if a company's capital can be brought forward and in case the Court sanctions same the winding up proceeding will be stayed by such an order (*In Re. Stephen Walters & Sons,* (1926) *W. N.* 236; 70 *Sol. J.* 953).

Forms of Resolutions for Reduction of Capital

The resolution for reduction must be so framed as to state with sufficient clearness exactly what is sought to be done by way of reduction more or less in the following form :—

RESOLVED :—That the capital of the company be reduced from Rs. 5,00,000 divided into 500 shares of Rs. 1,000 each to Rs. 3,00,000 divided into shares of Rs. 300 each and that the said reduction be effected by reducing the nominal amount of the said shares to Rs. 300 each extinguishing the liability in respect of the uncalled capital on the said shares to the extent of Rs. 200 per share.

In case of capital which has been reduced by cancellation of that part which has been lost or is unrepresented

by available assets the resolution may be passed in the following form :—

RESOLVED :—That the capital of this company be reduced from Rs. 5,00,000 to Rs. 4,00,000 and that such reduction be effected by cancelling the capital which has been lost or is unrepresented by available assets to the extent of and by the cancellation of Rs. 100 per share upon each of the shares of Rs. 500 of this company thereby reducing the nominal amount of the shares from Rs. 500 each to Rs. 400.

In the case where the reduction is to be effected by cancellation of a certain number of shares which were not issued to the public at all, the resolution will take the following form :—

RESOLVED :—That the capital be reduced from Rs. 5,00,000 to Rs. 4,00,000 by cancellation of 200 shares of Rs. 500 each which have not been taken up or agreed to be taken up by any person.

The general principle in connection with reduction is that where there is any unfairness to any class of shareholders the Court leaves it to the prescribed majority of shareholders to decide whether there should be a reduction of capital and if so how that should be carried into effect (*British & American Trustee Corporation* v. *Couper*, (1894) *A. C.* 399; *De La Rue & Co.*, (1911) 2 *Ch.* 361). The only point to be seen is that the rights of the creditors do not intervene.

Forms of Articles Empowering Reduction of Capital

The company may, from time to time, by special resolution, reduce its capital by paying off capital or cancelling capital which has been lost or is unrepresented by available assets, or reducing the liability on the shares, or otherwise, as may seem expedient, and capital may be paid off upon the footing that it may be called up again or otherwise; and paid up capital may be cancelled as aforesaid without reducing the nominal amount of the shares by the like amount to the intent that the unpaid and callable capital shall be increased by the like amount.

An alternative form of article :—

The company may, from time to time, by special resolution, reduce its share-capital in any way authorised by law and in particular, may pay off any paid-up share-capital upon the footing that it may be called up again or otherwise, and may, if and so far as it is necessary, alter its memorandum of association by reducing the amount of its share-capital and of its shares accordingly.

The scheme of reduction will only be allowed to pass if it is for an object contemplated by the act and thus in one case where the company had issued shares at a discount and sought to extinguish the remaining liability by writing down the capital such reduction was not allowed (*Re. New Chile Gold Mining Co.*, (1888) 38 *Ch. D.* 475). Later on a more level construction was placed on the question of the object of the Act and where shares were reduced and paid off under circumstances which were considered to be not quite regular the capital was allowed to be reduced by the Court by cancelling the shares (*Midland Railway Carriage Co.*, (1907) *W. N.* 175). In another case where an attempt was made to extinguish the founders' shares and issue a greater number of ordinary shares in exchange, the application was refused because an unlawful object namely an issue of the ordinary shares at a discount was contemplated (*Development Co. of Central and West Africa*, (1902) 1 *Ch.* 547). Of course when shares are once reduced they must be reckoned in winding up at the reduced amount (*Espuela Land & Cattle Co. No.* 2, (1909) 2 *Ch.* 187).

With reference to the registration of the order and minute of reduction of capital Sec. 61 lays down that :—

(1) "The Registrar on production to him of an order of the Court confirming the reduction of the share-capital of a company, and on the filing with him of a certified copy of the order and of a minute (approved by the Court) showing, with respect to the share-capital of the company as altered by the order, the amount of the share-capital, the number of shares into which it is to be divided and the amount of each share, and the amount (if any) at the date of the registration

deemed to be paid-up on each share, shall register the order and minute.

(2) On the registration, and not before, the resolution for reducing share-capital as confirmed by the order so registered shall take effect.

(3) Notice of the registration shall be published in such manner as the Court may direct.

(4) The Registrar shall certify under his hand the registration of the order and minute, and his certificate shall be conclusive evidence that all the requirements of this Act with respect to reduction of share-capital have been complied with, and that the share-capital of the company is such as is stated in the minute."

Correct Form of Minute and Notice for Reduction

In the above matter it has been held that the minute in the petition for reduction of capital should state that the capital has been reduced "by a special resolution confirmed by an order of the High Court of Justice" and in this case it is also sufficient compliance with the statute to give such notice in the short form approved in *Re. Oceana Development Co.*, (1912) 56 *Sol. J.* 537 and (1912) *W. N.* 121, and 138, which has removed the objection to the length of the minute (*Re. North Pole Ice Co. Ltd., & Reduced,* (1924) *W. N.* 131). But where the petition for reduction of capital does not involve sub-division, consolidation, or reorganisation of share-capital the old form of minute used in cases of simple reduction is correct and it is not necessary to state that the capital has been reduced by virtue of a special resolution and with the sanction of an order of the High Court of Justice (*Re. Dampney & Co., Ltd., and Reduced,* (1924) 68 *Sol. J.* 718). The minute must thus state the amount paid upon each share and in cases where different amounts are paid on each share the same should be indicated by serial number of such shares and the amount paid on each. Where the shares are renumbered on sub-division, the new numbers should be stated but the minute must show the sub-division (*London & R. M. & Land Co.,* (1919) 36

T. L. R. 87; *Salinas of Mexico,* (1919) *W. N.* 311). Forms of Minutes are given in Vol. II Appendix B.

PROCEDURE AS TO REDUCTION

The procedure as to reduction is that a special resolution giving effect to the reduction sought after it is passed as provided by the Indian Companies Act. In case the reduction involves a simple cancellation of shares which were never taken up, or agreed to be taken up, all that is necessary is to register a special resolution with the registrar of joint stock companies in proper time. In all other cases of reductions, the sanction of the Court must be obtained through a petition. All the High Courts of India have formulated their own rules in connection with these matters under the powers reserved to them under the Act. These rules also provide for prescribed forms of orders, notices, advertisements, etc., and are known as rules and forms applying to company matters. After passing the special resolution the following steps will have to be taken :—

(1) Present the petition for confirmation by the Court of the resolution of the reduction, the company being the petitioner. The petition has to be supported by the necessary affidavit as the rules of the High Court concerned provide. When the reason for reduction is loss of capital, it is usual to state that in the affidavit, also the reserve fund if there is any (*In Hoare & Co.,* (1904) 2 *Ch.* 208). Besides this, exhibits to the affidavit should be (1) the memorandum and articles (2) the incorporation certificate (3) the minute book containing the resolutions for reduction (*Re. Omnium Investment Co.,* (1895) 2 *Ch.* 127) and (4) the last balance sheet. Where fully paid shares are issued the affidavit should state that the contract for the same was duly lodged with the registrar.

(2) The company must use the words "and reduced" from the date of the presentation of the petition to its name as the last words in it unless the Court has

specially sanctioned to dispense altogether with the addition of these words which it will do where the Court thinks that the reduction does not involve either the diminution of any liability in respect of unpaid share-capital or the payment to any shareholder of any paid-up share-capital (S. 57).

(3) The company should take directions from the Court as prescribed in the rules through a chamber summons for directions as to the proceedings which are to be taken preliminary to the hearing of the petition such as advertising the petition, etc.

(4) Next an application has to be presented by summons in chambers for directions as to the proceedings to be taken for settling the list of creditors who are entitled to object to the proposed reduction.

(5) The list of creditors has to be prepared and presented in the Court with an affidavit made by some officer or officers of the company competent to make the same, verifying the list of the names and addresses of creditors and the nature and amounts of debt due to them.

(6) The notice of the settlement of the list of creditors must be published in such newspapers as the Court may direct and at the same time the same should be served on each creditor whose name is entered on the list.

(7) When the petition comes up for hearing, after hearing any creditor or creditors who may be present to object, the Court would sanction the reduction if satisfied that (1) no creditors are objecting or (2) that in case of objection by a creditor his consent has been subsequently obtained or (3) that his debt or claim has been discharged or secured (S. 60). Where the creditor objects to the reduction, the Court may either (1) dispense with the creditor's consent or (2) where the company admits full amount of debt or claim or though not admitting it is willing to provide for it. Court may direct the amount to be secured or (3) when the company does not

admit the claim or is not willing to provide for the full amount of the debt or claim or if the amount is contingent or not ascertained, then an amount fixed by the Court may have to be secured as Court may direct. The fixing of the amount is made after inquiry and adjudication as if the company were to be wound up by the Court (S. 59). A landlord's claim for future rent, was held not to be contingent (*Palace Billiard Rooms*, (1912) *S. C.* 5; see also *Telegraph Construction Co.*, (1870) *L. R.* 10 *Eq.* 384).

(8) The next step is to produce before the registrar the order of the Court confirming the reduction of share-capital and file with him a certified copy of the order and of a minute approved by the Court showing, with respect to share-capital of a company as altered by the order, the amount of the share-capital, the number of shares into which it is to be divided and the amount of each share and the amount, if any at the date of the registration deemed to be paid on each share [S. 61 (1)]. The notice of registration of this reduction shall be published in such manner as the Court may direct and registrar shall certify under his hand the registration of the order and minute. His certificate shall be conclusive evidence that all the requirements of the section with respect to reduction of share-capital have been complied with and that the share-capital of the company is such as is stated in the minute [S. 61 (3) (4)]. This minute when registered shall be deemed to be substituted for the corresponding part of the memorandum of association of the company and shall be valid and unalterable as if it had been originally contained therein, and shall be embodied in every copy of the memorandum issued after its registration. Any default in complying with this would entail a fine not exceeding Rs. 10 for each copy in respect of which the default is made and every officer of the company who knowingly or wilfully authorises or permits the default shall be liable to a like penalty (S. 62). The liability of every member past and present will now be

the difference, if any, between the amount paid or deemed to be paid and the amount of the share as fixed by the minute of reduction (S. 63).

NOTE :—Section 64 makes it a punishable offence with imprisonment if any officer of the company wilfully conceals the name of any creditor entitled to object to the reduction or wilfully misrepresents the nature or the amount of the debt or claim of any creditor.

The Court may also require the reasons for such reduction to be published with such information, in regard thereto, as the Court may think expedient with a view to give proper information to the public as to the causes which led to the reduction (S. 65). This is very rare now and is done in exceptional cases say where loss is very large and sudden or such other cause (*Truman, Hanbury B. & Co.,* (1910) 2 *Ch.* 498).

(9) In the case of companies limited by guarantee with a share-capital the reduction, if authorised by the articles, or increase of the capital, may be made in the same manner and subject to the same conditions as in case of a company limited by shares. It may be further added that the procedure as provided by the sections of the Act in connection with reduction cannot be dispensed with even though there may be no creditors (*Re. Lamson Store Service Co.,* (1895) 2 *Ch.* 726).

NOTE :—For forms of petition in case of alteration of name, objects clause and capital clause, etc., see appendix and index.

Subsequent Increase of Liability of Members

In this connection it is now specifically provided for by the S. 20A of the Indian Companies (Amendment) Act of 1936 that *notwithstanding anything in the memorandum and the articles of a company, no member of the company shall be bound by an alteration made in the memorandum or articles, after the date on which he became a member, if and so far as the alteration requires him to take or subscribe for more shares than the number held by him at the date on which the alteration is made,*

or in any way increases his liability as at that date, to contribute to the share-capital of, or otherwise to pay money to the company. This does not apply to a case where the member agrees in writing either before or after the alteration to be bound thereby.

FORFEITURE OF SHARES

We have seen that the directors are empowered to make calls and are under the duty to recover the amount of such calls. Forfeiture affords an excellent method of enforcing such payments. This power cannot be exercised by the directors or shareholders unless the articles reserve the same for them because forfeiture is in fact a reduction of capital (*Munt's Case,* (1856) 22 *Beav.* 55; *Spackman* v. *Evans,* (1868) *L. R.* 3 *H. L.* 171; *Hart* v. *Clarke,* (1858) 6 *H. L. C.* 633). In the last mentioned case it was laid down that the power to forfeit shares is not inherent in a company. Powers to this effect may be introduced in the articles by a special resolution (*Dawkins* v. *Antrobus,* (1881) 17 *Ch. D.* 615; *Allen* v. *Gold Reefs of West Africa,* (1900) 1 *Ch.* 656). The Table "A," clause 24 lays down to the effect that, in case a member fails to pay any call, or instalment on a call, on the date appointed for payment, the directors may serve such a member with a notice requiring payment of such call, or instalment, and give him at least 14 days' notice within which to pay up the call in arrear, pointing out to him that in case of failure to pay, the shares in respect of such calls are made will be forfeited. If a defaulting member does not pay up in spite of this notice, Table "A," clause 26, empowers the directors to forfeit the shares. This power, of course, will apply to companies who have adopted Table "A" as their articles fully, or partly; otherwise, the special articles must reserve these powers. Where shares are allowed to be forfeited, they may be re-sold, or reissued, at a value equivalent to the amount actually called up on such a share. In re-selling

this, the actual amount which was paid by the shareholders on such forfeited shares may be allowed as a deduction, but nothing more. This deduction will not be treated as an issue at a discount. It should be remembered that power to forfeit shares should only be exercised where there are no prospects of recovering the money due and should not release a solvent member from liability (*Spackman* v. *Evans,* (1868) *L. R.* 3 *H. L.* 171; *Esparto Trading Co.,* (1879) 12 *Ch. D.* 191).

When the forfeiture is thus enforced, the directors should see that all the requirements of the articles are strictly complied with. Care should be taken in claiming the amount of call and interest in the forfeiture notice, not to ask for anything more than what is actually due, as otherwise, the forfeiture and the notice may be held to be bad. In one case, where in the forfeiture notice, interest was claimed from the date of call, instead of claiming same from the date on which the call was payable, the forfeiture was declared to be bad (*Johnson* v. *Lyttles Iron Agency,* (1877) 5 *Ch. D.* 687). It should be also noted that a valid call and default are conditions precedent to and necessary for a valid forfeiture. Also that when the power of forfeiture is over-exercised directors cannot rely on their irregularity and revoke forfeiture without consent of contributory. Forfeiture which is not strictly in accordance with the procedure laid down in the articles, is *ultra vires* (*Bhagirath S. & W. Co.* v. *Balaji Bhavani Power,* (1930) 32 *Bom. L. R.* 87). When the forfeiture is resolved upon, the directors should see that the proper *quorum* is present of the board meeting. Improper forfeiture may lead to an action for damages (*New Chile Gold Mining Co., No.* 2, (1890) 45 *Ch.* 598). Where articles empower the directors to sell or re-allot forfeited shares as property of the company these should be treated as unissued and nothing paid on them even though a part is paid for (*Wolfe* (*Thomas*) *& Son,* (1912) *W. N.* 286; *Victoria* (*Malaya*) *Rubber Estates,* (1914) *W. N.* 307). Once the shares are forfeited, the shareholder

is exonerated from liability as to future calls. But he still remains liable for the calls made before the forfeiture was enforced and which were not paid, if the articles of the association of that company so provide (*Ladies Dress Association* v. *Pulbrook*, (1900) 2 *Q. B.* 376; *Randt Gold Mining Co.* v. *Wainwright*, (1901) 1 *Ch.* 184). If such a clause is not incorporated in the articles the shareholder is free from liability on the calls made and unpaid before forfeiture (*Stocken's Case*, (1868) 3 *Ch.* 415).

When shares are forfeited according to the powers reserved in the articles, after due notice and a proper resolution, the amount falls due as from the date of the forfeiture resolution, because such an article constitutes a special contract between the shareholder and the company, whereby the shareholder agrees that in the event of shares being forfeited he would be liable to pay the allotment or calls money already due with interest. The limitation therefore begins to run against the company for all the moneys due by him from the date of actual forfeiture (*Habib Rowji* v. *Standard Aluminium & Brass Works*, (1925) 27 *Bom. L. R.* 574). In a later case it was further enunciated that forfeiture under powers in the articles of association imposes a new obligation and a new debt and therefore limitation runs from the date of forfeiture and was governed by article 115 of the Indian Limitation Act (*Maneklal* v. *Suryapur Mills Co.*, (1928) 30 *Bom. L. R.* 549).

The power to forfeit cannot be exercised collusively for the purpose of assisting a shareholder to get rid of the shares and retire from the company in fraud of other shareholder. *In Re. Agriculturalist C. In. Co.*, (1866) 1 *Ch. App.* 161, where the directors by agreement with a shareholder wrongfully declared his share forfeited on the excuse of non-payment of a call, and the company went into liquidation twelve years thereafter, the whole arrangement was declared void and the shareholder was ordered to be replaced on the list of contributories.

In *Re. Agency Land Finance Co.*, (1904) 20 *T.*

L. R. 41, where the company had, by a deed, given a charge on the uncalled capital of the company to the debenture holders, it was decided that in spite of this charge, the directors can forfeit the shares according to powers reserved to them in the articles of association. In some articles powers are reserved to directors to annul forfeiture upon such terms as they think fit and that notwithstanding forfeiture the shareholder can be reinstated and forced to pay future calls. This power cannot be exercised without the shareholder agreeing, and unless that is done, is inoperative (*In Re. Exchange Trust, Ltd.,* (1903) 1 *Ch.* 711).

When the company is in liquidation the right of forfeiture may be enforced by the liquidator through the help of directors (*Fairbairn Engineering Co.,* (1893) 3 *Ch.* 450). It has been further held that when forfeited shares are sold, the purchaser of the shares cannot vote until all the calls are paid (*Randt Gold Mining Co.* v. *Wainwright,* (1901) 1 *Ch.* 184). It has also been held that the right of forfeiture, if vested in directors, should be exercised for the benefit of the company, and that, if not so *bona fide* exercised, the forfeiture may be set aside (*Re. Esparto Trading Co.,* (1879) 12 *Ch. D.* 191). If there is a clause in the company's articles to the effect that, in case a shareholder were to take any proceedings against the company the shares will be forfeited, such a clause will be void and inoperative (*Peveril Gold Mines, Ltd.,* (1898) 1 *Ch.* 122). It may be further added that when the directors have exercised the right *bona fide,* equity will not give any relief against it (*Sparks* v. *Liverpool Waterworks Co.,* (1807) 13 *Ves.* 428).

Of course a collusive forfeiture would be entirely invalid with the result that the shareholder will remain a member (*Spackman* v. *Evans,* (1868) *L. R.* 3 *H. L.* 171). There cannot also be an article giving power of forfeiture of share with a view to enforce the company's lien for non-payment of debt because that would be illegal as a reduction of capital and also as a clog on the equity of

redemption (*Hopkinson* v. *Mortimer & Co.,* (1917) 1 *Ch.* 646). In another case decided later where the powers tc forfeit for non-payment of calls existed it was held that the forfeiture was good as it was effected under the said power only which was valid (*Re. Bolton ex-parte North British Artificial Silk, Ltd.,* (1930) 2 *Ch.* 48). Of course care should be taken that the forfeiture is carried out by a duly constituted board of directors properly appointed and when a quorum is present (*Garden Gully Co.* v. *McLister,* (1875) 1 *A. C.* 39; *Bottomley's Case,* (1881) 16 *Ch. D.* 681). Of course if in every other respect the forfeiture is regular a simple irregularity such as the failure to inform the member, or strike his name off the register, will not invalidate the forfeiture (*Lyster's Case,* (1867) 4 *Eq.* 233). The Court would interfere and restrain a forfeiture if the shareholder is seeking to rescind his contract (*Lamb* v. *Sambas Rubber Co.,* (1908) 1 *Ch.* 845; *Jones* v. *Pacaya Rubber Co.,* (1911) 1 *Q. B.* 455). The shareholder who wants to challenge the forfeiture must not lose time because if the shares are sold away to a *bona fide* purchaser, the title of the buyer will be perfect in which case the shareholder will only get damages (*New Chile Gold Mining Co., No.* 2, (1890) 45 *Ch. D.* 598). The shareholder has also the remedy when the forfeiture is threatened improperly to move the Court to restrain the forfeiture by injunction (*Jones* v. *North Vancouver Land Co.,* (1910) *A. C.* 317). The Limitation runs for the suit from the date of forfeiture because the liability arises under the clause which constitutes a special contract (*Habib Rowji* v. *Standard Aluminium Co., Ltd.,* (1925) *I. L. R.* 49 *Bom.* 715). Articles usually while laying down the power of forfeiture state that in spite of the forfeiture the shareholder concerned will remain responsible for the calls already made. In the absence of such a clause the shareholder will be free from liability for past as well as future calls, but where the company is wound up within a year of forfeiture he will be liable as a past member under Sec. 156 (*Stocken's Case,* (1868)

3 *Ch.* 415; *Re. Allahabad Trading Co.,* (1869) *I. N. W. P. H. Crt. Reports* 101, *Creyke's Case,* (1869) *L. R.* 5 *Ch. Appl.* 63). Of course if the shares were allotted to him under fraud by the company, or its agent, the shareholder can repudiate the bargain and defend an action for calls even after the forfeiture (*Aaron's Reefs* v. *Twiss,* (1896) *App. Ca.* 273), and the forfeiture can be cancelled with the consent of the former owner (*Exchange Trust,* (1903) 1 *Ch.* 711). The company or its liquidator may in some cases be precluded from setting up that a forfeiture is invalid owing to irregularities in forfeiture (*New Sombrero* v. *Erlanger,* (1878) 3 *A. C.* 1213). A valid forfeiture holds good against the liquidator (*Dawe's Case,* (1868) *L. R.* 6 *Eq.* 232). It also holds good even though the shareholder's name is not struck off from the register of members (*Lyster's Case,* (1867) 4 *Eq.* 233). Laches on the part of a shareholder may prevent him from getting relief against forfeiture when the same is irregular, but not when the same is void (*Rule* v. *Jewell,* (1881) 18 *Ch. D.* 660; *Bellerby* v. *Rowland & M. S. Co., Ltd.,* (1902) 2 *Ch.* 14). The company cannot prove in bankruptcy of a person whose shares have been forfeited for anything more than the difference between the amount of unpaid capital at the date of forfeiture and the amount received from subsequent holders of the shares (*Re. Bolton ex-parte North British A. S. Ltd.,* (1930) 2 *Ch.* 48). Frequently articles provide that the amount due on forfeiture is recoverable with interest if any in which case the interest is recoverable from the date on which the call was payable till forfeiture, not otherwise (*Faure Electric A. Co.* v. *Phillipart,* (1888) 58 *L. T.* 525; *Stocken's Case,* (1868) 3 *Ch. Ap.* 412). If however, the payment of calls is guaranteed the company by forfeiting on non-payment of calls releases the surety from his liability (*Darwen & Pearce,* (1927) 1 *Ch.* 176). /There is no objection of course while reselling the shares that are forfeited if the credit is given to the buyer for money already received, because the reallotment is not in law an issue of shares and thus the prin-

ciple that shares cannot be issued at discount does not apply (*Morrison* v. *Trustees' Executors Corporation*, (1898) *W. N.* 154, 68 *L. J. Ch.* 11). On a reduction of capital forfeited shares have been treated as unissued where sums had already been received in respect of shares (*Re. Oceana Development Co., Ltd.*, (1912) 56 *Sol. J.* 537). With reference to reduction of capital it has been laid down that a voluntary transfer of fully paid shares to a trustee to hold them for the benefit of the company is not a reduction of capital and is therefore valid (*Kirby* v. *Wilkins*, (1929) 2 *Ch.* 444). In case of deceased member so long as his name remains on the register of the members his estate will be liable (*New Zealand Gold Company* v. *Peacock*, (1894) 1 *Q. B.* 622; *Bombay Burma Trading Corporation* v. *Smith*, (1894) 19 *Bom.* 1; *Tricumdas Mills* v. *Haji Saboo*, (1902) 4 *Bom. L. R.* 215). The sole surviving co-partner of a Hindu shareholder who is dead cannot be registered in respect of the deceased shareholder without producing probate or letters of administration if the company's articles of association make it a condition precedent (*Bank of Bombay* v. *Ambalal*, (1900) 24 *Bom.* 350). The company or the liquidator are precluded from setting up that the forfeiture is invalid owing to irregularities (*New Sombrero* v. *Erlanger*, (1878) 3 *A. C.* 1213). A defendant who resists a forfeiture on the ground that he was induced to take shares by misrepresentation, must show that he was not guilty of delay (*First National Re-insurance Co.* v. *Greenfield*, (1921) 2 *K. B.* 260). Simply because there was an execution of the charge on uncalled capital in favour of the trustees for the debenture holders it was held that the power of the directors to forfeit for non-payment of calls was not lost (*Re. Agency Land and Finance of A. Ltd.* v. *Agency Land & Finance Co. of A. Ltd.*, (1904) 20 *T. L. R.* 41). A call which fell due while the moratorium was in force was considered declared to be invalid and where the directors forfeited the shares for non-payment of such a call it was also declared bad (*Burges* v. *O. H. N. Gassis Ltd.*, (1914)

31 *T. L. R.* 59). It must however be noticed that the forfeiture cannot be used for the purpose of buying out shareholders with whom there is a quarrel or to pay money of the company to the shareholders who wish to retire even where the articles appear to authorise such a course (*Morgan's Case,* (1849) 1 *Mac. & G.* 225; *Trevor* v. *Whitworth,* (1888) 12 *A. C.* 409). Of course, there would be no objection if the directors or other members paid out shareholders by paying their own money as purchasers (*Trevor* v. *Whitworth,* (1888) 12 *A. C.* 409). A clause in the articles that the shares will be *ipso facto* forfeited on non-payment of calls will not take effect until directors declare the forfeiture (*Bigg's Case,* (1865) 1 *Eq.* 309). A company cannot cancel the shares it has forfeited as the Act only recognises the cancellation of unissued shares (*Marshall* v. *Glamorgan,* (1868) 7 *Eq.* 129).

It may be added that, if the shares are wrongfully forfeited, the shareholder concerned is entitled to bring an action to set the forfeiture aside and also to prove in the winding up of the company in competition with other creditors (*Sweny* v. *Smith,* (1869) 7 *Eq.* 324; *New Chile Gold Mining Co.,* (1890) 45 *Ch. D.* 598). It may be further added that a liquidator has no power to cancel a forfeiture of shares duly made by the Directors before the commencement of the winding up (*Dawe's Case,* (1868) *L. R.* 6 *Eq.* 232). When the shares forfeited are resold, the calls which were not paid must be paid up by the purchaser as soon as a fresh call is made on him by the company (*New Balkis Eersteling* v. *Randt Gold Mining Company,* (1904) *A. C.* 165). If, however, after such payment by the purchaser calls are recovered from the shareholder whose shares were originally forfeited the amount so recovered should be credited to the purchaser (*Randt Gold Mining Company,* (1904) 2 *Ch.* 468). In case of voluntary liquidation, the directors can with the sanction of the liquidator exercise the power of forfeiture (*Re. Fairbairn Engineering Company, Ladd's Case,* (1893) 3 *Ch. D.* 450). A shareholder who has been induced to purchase shares

by fraud can repudiate the transaction even after forfeiture (*Aaron's Reef* v. *Twiss* (1896) *A. C.* 273).

SURRENDER OF SHARES

Besides the right to forfeit there is what is called the power to surrender shares. This power to surrender should also have been expressly given, otherwise, it will be invalid if exercised. (*Munt's Case,* (1856) 22 *Beav.* 55). This right to surrender is frequently described as a short-cut to forfeiture. In *Trevor* v. *Whitworth,* (1888) 12 *App. Cas.* 409 it was held that this was a power which can be rarely exercised without the consent of the Court, unless the company has a right to forfeit shares and such right has already accrued. It was further held in the same case, that a surrender in consideration of the payment of money, or money's worth, by the company, was a purchase by it of its own shares and was therefore *ultra vires* and it was also held to be equivalent to a purchase by the company. The surrender of shares, which are partly paid, in consideration of the discharge of liability on them, is a purchase by a company of its own shares.

A surrender of partly paid shares, on condition that the shareholders will be released from the payment of the balance is *ultra vires* as it constitutes a purchase by the company of those shares and in such cases even after a long period the shareholders can be restored to the register of members (*Bellerby* v. *Rowland and Marwood's Steamship Co.,* (1902) 2 *Ch.* 14). In case of the surrender of fully paid shares also, the sanction of the Court must be obtained in order to render the payment of a dividend possible which otherwise would be unlawful (*Re. Denver Hotel Co.,* (1893) 1 *Ch.* 495). In connection with the question how far the shares can be surrendered in exchange of new shares there is considerable conflict of decisions. but the balance of view happens to be that it would be virtually speaking a purchase of shares in exchange of the new shares. A transaction such as the above was held good in *Teasdale's Case,* (1873) 9 *Ch.* 54 and in *Eichbaum*

v. *City of Chicago*, (1891) 3 *Ch*. 459. Eichbaun's case was, in a later case, namely, *Bellerby* v. *Rowland*, (1902) 2 *Ch*. 14, differed from and in *Rowell* v. *John Rowell & Sons*, (1912) 2 *Ch*. 609 the same was upheld and a similar transaction was held good. Of course, a surrender as a short cut to forfeiture that is where all the circumstances for the forfeiture have arisen may be made (*Trevor* v. *Whitworth*, (1888) 12 *A. C.* 409). Even though the contract to purchase its own shares by the company in these circumstances are invalid that fact will not relieve persons who have guaranteed to purchase (*Garrard* v. *James*, (1925) *Ch*. 616). An unlimited company may purchase its own shares where its articles give it the power but not otherwise (*Borough Commercial and Building Society No*. 1, (1893) 2 *Ch*. 242; *Spackman* v. *Evans*. (1868) *L. R.* 3 *H. L.* 171). In one case where dividends on preference shares in a company were several years in arrear, a scheme approved by the shareholders, was sanctioned by the Court, whereby the ordinary shareholders surrendered part of their holding to the preference shareholders on the latter consenting to waive their right to the arrears of dividends. Under the scheme trustees were appointed who received the ordinary shares in lieu of arrears of dividend of a block of preference shares forming part of the trust estate. It was also held here that the ordinary shares in the hands of the trustees were to be treated as income and belonged to the tenant for life (*MacIver's Settlement, in re. MacIver* v. *Rae*, (1936) *Ch*. 198).

Articles as to Forfeiture

These articles take various forms. In the Table "A" articles 24 to 29 inclusive deal with these points for which reference may be made to the Table in Vol. II Appendix, Appendix C where the text of the Indian Companies Act, 1913 is appended. The following forms selected from the articles of an Indian Company are however generally used in this country :—

FORFEITURE OF SHARES

(1) If any shareholder fails to pay any money due from him in respect of any call made on a share on the day appointed for payment or any interest in respect of such call and any expenses that may be incurred thereon, the directors or any person authorised by them for that purpose may at any time thereafter during such time as such money remains unpaid give notice to such shareholder or to his legal personal representatives either by advertisement in one English and one Vernacular daily newspaper published in Bombay or by writing sent to the registered address of such shareholder through the post or by messenger requiring payment of the money payable in respect of such share call, or interest and expenses incurred thereon.

If calls are not paid notice to be given to the shareholder.

(2) The notice shall name a day (not being less than ten days from the date of the notice) and a place or places on and at which the money due as aforesaid is to be paid and the notice shall also state that in the event of the non-payment of such money at the time and place appointed, the share or shares in respect of which the same is owing will be liable to be forfeited.

Notice to name a further day.

(3) If the requisitions of any such notice be not complied with, every share, in respect of which the notice is given, may, at any time thereafter, be declared forfeited by a Resolution of the directors to that effect, without any further communication with such shareholder.

Notice if not complied with shares to be forfeited.

(4) When any share is declared to be so forfeited notice of the forfeiture shall be given to the holder or holders of such share either by advertisement in one English and one Vernacular daily newspaper published in Bombay or, by writing, sent to the registered address of the holder or holders of such share through the post or by a messenger.

Notice after forfeiture.

Forfeited share may be sold, reallotted or otherwise disposed of or may be taken over by the Directors.

(5) Every share, which shall be so declared forfeited, shall thereupon be the property of the company and may, at any time thereafter, be sold, reallotted or otherwise disposed of to the original holder thereof or to any other person and either by public auction or by private sale upon such terms and in such manner as the Directors shall think fit.

Shareholders liable to pay calls due notwithstanding the forfeiture.

(6) Any shareholder, whose shares may be forfeited, shall, notwithstanding the forfeiture, be liable to pay to the company, all money owing upon the shares at the time of forfeiture and the interest (if any) due thereon and all expenses incurred by the company relating to the forfeiture of the shares.

When share is forfeited all dividends and bonuses due thereon to the shareholder shall be forfeited.

(7) The forfeiture of the share shall involve the extinction, at the time of the forfeiture, of all interest in all claims and demands against the company in respect of the share and all dividends and bonuses due and payable in respect thereof and also all other rights incidental to the share.

FORFEITURE RESOLUTION

The resolution for forfeiture of shares would run as follows :—

Resolved :—That 10 ordinary shares of Rs. 500 each with Rs. 200 paid-up and numbered 1,501 to 1,510 inclusive held by Mr. Jamnadas Pragji be forfeited, he being in arrear with the second call of Rs. 200 made on the 27th May, 1933, and payable on or before 10th June, 1933, in spite of notice served on him on 15th August, 1933, in accordance with Clause 76 of the articles of association.

In case of notice to be given before forfeiture, the resolution would run as follows :—

Resolved :—That notice be given in accordance with Clause 74 of the articles of association to Mr. Jamnadas Pragji, who has made default for more than fifteen days in payment of the calls payable on or before 10th June, 1933.

POWER TO EXPROPRIATE

In case of private companies, it is nowadays very common to provide in the articles, or to acquire subsequently by an alteration of the articles a power to expropriate a member or shareholder in certain circumstances, such as competing with the company, or joining in the service of a competing firm or association or for some other equally appropriate reason. As long as this course is for the benefit of the company as a whole the tendency of the Courts has been not to interfere. The principle laid down in this matter as early as the year 1900 by *Lindley, M.R.* is that the power to alter the articles as given by Sec. 20 of the Indian Companies Act of 1913 "must be exercised, not only in the manner required by law, but also *bona fide* for the benefit of the company as a whole and it must not be exceeded" (*Allen* v. *Gold Reefs of West Africa Ltd.*, (1900) 1 *Ch. D. at p.* 656-671).

The principle enunciated in the above decision has influenced all subsequent cases. A further point which was made clear in this case was that "the power conferred by it (meaning S. 20) like all other powers, must be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities." When, therefore, a subsequent case came up before the Courts in which a company was in great need of further capital and holders of 98 per cent of the shares were willing to provide this capital if they could buy out 2 per cent minority, they made an attempt to buy these shares by private treaty and failing that, attempted to obtain that power by trying to alter the articles which would enable them to compulsorily acquire same. The Court refused to allow this alteration laying down that the alteration was not just or equitable for the benefit of the company as a whole but was simply for the benefit of the majority. They held therefore that under Sec. 20 such an article cannot be forced by the majority on the minority. Thus the principle enunciated

is that in order to fall within the terms of being "for the benefit of the company as a whole," it will not do if it is shown that it will benefit the majority (*Brown* v. *British Abrasive Wheel Co., Ltd.,* (1919) 1 *Ch. D. at p.* 290).

Two later decisions on this point may be noted. Though these decisions mainly turn on the question of the company's power to expropriate certain shareholder or shareholders in the interests of the company, the principle involved and the rule of law laid down are also interesting and may be considered with the company's power to accept surrender of shares. In *Sidebottom* v. *Kershaw, Leese & Co., Ltd.,* (1920) 1 *Ch. D.* 154, a company altered its articles of association by a special resolution, and took powers by which its director could call upon any shareholder who competed with the business of the company to transfer his shares to the nominee of the directors at the full value. It was here contended that such a power was invalid, but the Court held that as long as the alteration was *bona fide* for the benefit of the company, a joint stock company was empowered by S. 13 of the English Companies Act, 1908, to do so (S. 20 being the corresponding section of the Indian Act of 1913). Thus according to this decision, the directors can compel a shareholder to transfer his share to a nominee, provided they acted *bona fide* in the interest of the company. On the same principle in *Dafen Tinplate Co.* v. *Llanelly Steel Co.,* (1920) 2 *Ch. D.* 124 where the articles of association were altered giving powers to the majority of shareholders to acquire compulsorily shares of any members and offer them for sale, through the directors to members or outsiders as they think fit, at a fair value to be fixed, from time to time, by the directors, it was held that such a resolution, which conferred an "unlimited and unrestricted power on the majority to expropriate" any shareholder at their pleasure, is not in the interest of the company as a whole and therefore cannot be allowed.

There is one other case, *viz., Shuttleworth* v. *Cox Bros.,*

and Co. Ltd., (1927) 2 *K. B. at p.* 9, where an attempt was made to alter the articles by a special resolution with a view to get rid of a director by adding in the articles one more circumstance under which a director can be forced to resign. Here when the question came up before the Court, the Court went one step further and laid down that there being no evidence of bad faith, there was no ground for questioning the decision of the shareholders that the alteration was for the benefit of the company. Here a new principle was laid down, namely, that it was for the shareholders and not for the Court to say whether an alteration of the articles is for the benefit of the company provided that it is not of such a character that no reasonable man could so regard it. Here the dictum laid down in *Dafen Tinplate Co.* v. *Llanelly Steel Co.*, as quoted above was disapproved.

FORMS OF ARTICLES FOR EXPROPRIATION

The expropriation clauses are generally inserted in articles more or less in the following form :—

Expropriation of Competitive Shareholders

(1) At any ordinary or extraordinary general meeting the ordinary shareholders may by ordinary resolution expropriate any competitive shareholder or shareholders, whether, if there are more than one competitive shareholder, they are acting and proposing to act collectively or otherwise, and whether such shareholders hold preference or ordinary shares; but this provision shall not apply to *........................

For the purpose of regulations a shareholder is deemed to be a competitive shareholder if he is or appears to be either by himself or with some other persons jointly, or as a member, officer or employer of another company engaged in or about to engage in the business of † banker, financier or loan broker or money-lender under any designation whatsoever whether in India or elsewhere unless with the written consent previously obtained from the board of directors of this company.

* Here the names of members, if any, to be exempted from the operation of this rule may be mentioned.

† Here state any other business that may be appropriate.

(2) If any such member is expropriated, he shall be entitled to recover from such transferee or transferees of his share, such in all the circumstances and having regard to the fact of his reasonable sum or sums as the company in general meeting may, expropriation on the position of the company, think just, being not less than one-half of the paid-up value thereof, but without prejudice to such greater or smaller sum as may be agreed to be paid between the expropriated member and the transferee or transferees. The value placed on each share of the company shall be certified to the expropriated shareholder by the Secretary of the Company.

REGISTRATION FEES

The following is the Table of Registration Fee according to Table "B," to be paid to the Registrar. (Ss. 249 and 262)

FORM No. 1.

FIRST SCHEDULE—TABLE B

(See Sections 249 and 262).

TABLE OF FEES TO BE PAID TO THE REGISTRAR

I. By a company having a share-capital.

	Rs.	A.	P.
1. For registration of a company whose nominal share-capital does not exceed Rs. 20,000 a fee of ..	40	0	0
2. For registration of a company whose nominal share capital exceeds Rs. 20,000 the above fee of forty rupees, with the following additional fees regulated according to the amount of nominal capital (that is to say) :—			
For every 10,000 rupees of nominal capital, or part of 10,000 rupees, after the first 20,000 rupees up to 50,000 rupees	20	0	0
For every 10,000 rupees of nominal share-capital, or part of 10,000 rupees after the first 50,000 rupees up to 10,00,000 rupees	5	0	0
For every 10,000 rupees of nominal share-capital, or part of 10,000 rupees after the first 10,00,000 rupees	1	0	0
3. For registration of any increase of share-capital made after the first registration of the company, the same fees per 10,000 rupees or part of 10,000 rupees, as would have been payable if such			

	Rs.	A.	P.
increased share-capital had formed part of the original share-capital at the time of registration. Provided that no company shall be liable to pay in respect of nominal share-capital on registration, or afterwards, any greater amount of fees than 1,000 rupees taking into account, in the case of fees payable on an increase of share-capital after registration, the fees paid on registration.			
4. For registration of any existing company, except such companies as are by this Act exempted from payment of fees in respect of registration under this Act, the same fee as is charged for registering a new company.			
5. For filing any document by this Act required or authorised by the said Act or the rules made thereunder other than the memorandum of the abstract required or the statement required to be filed with the registrar by the liquidator in a winding up, 109 and 110	3	0	0
6. For making a record of any fact by this Act authorised or required to be recorded by the registrar, a fee of	5	0	0

II.—By a company not having a share-capital.

	Rs.	A.	P.
1. For registration of a company whose number of members, as stated in the articles of association, does not exceed 20	40	0	0
2. For registration of a company whose number of members, as stated in the articles of association, exceeds 20, but does not exceed 100	100	0	0
3. For registration of a company whose number of members, as stated in the articles of association, exceeds 100, but is not stated to be unlimited, the above fee of Rs. 100 with an additional Rs. 5 for every 50 members or less number than 50 members, after the first 100			
4. For registration of a company in which the number of members is stated in the articles of association to be unlimited, a fee of	400	0	0
5. For registration of any increase on the number of members made after the registration of the company, the same fees as would have been payable in respect of such increase if such increase had been stated in the articles of association, at the time of registration			

	Rs. A. P.
Provided that no one company shall be liable to pay on the whole a greater fee than Rs. 400 in respect of its number of members, taking into account the fee paid on the first registration of the company	
6. For registration of any existing company except such companies as are by this Act exempted from payment of fees in respect of registration under this Act, the same fee as is charged for registering a new company	
7. For filing any document by this Act required or authorised by the said Act or rules made thereunder, other than the memorandum or the abstract required to be filed with the registrar by a receiver or the statement required to be filed with the registrar by the liquidator in a winding up ..	3 0 0
8. For making a record of any fact by this Act authorised or required to be recorded by the registrar, a fee of	5 0 0

In pursuance of Section 249 of the Indian Companies Act, 1913 (VII of 1913) and in supersession of the Notification of the Government of India in the Department of Commerce and Industry, No. 6161-26, dated the 22nd July, 1916, the Governor-General in Council is pleased to direct that in place of the fee specified in items Nos. 5 and 7 respectively, of Parts I and II of Table B in the First Schedule of the said Act, the following reduced fees shall be paid to the Registrar in respect of the matter hereinafter mentioned, namely—

For filing returns of allotments prescribed by Section 104 of the said Act :—

	Rs. A. P.
In cases in which the aggregate paid-up value of the shares allotted does not exceed Rs. 25 ..	0 4 0
In cases in which the aggregate paid-up value of the shares allotted exceeds Rs. 25 but does not exceed Rs. 50	0 8 0
In cases in which the aggregate paid-up value of the shares allotted exceeds Rs. 50 but does not exceed Rs. 75	0 12 0

	Rs.	A.	P.
In cases in which the aggregate paid-up value of the shares allotted exceeds Rs. 75 but does not exceed Rs. 100.	1	0	0
In cases in which the aggregate paid-up value of the shares allotted exceeds Rs. 100	3	0	0

For filing any other document required or authorised by the said Act or Rules made thereunder, other than the memorandum or the abstract required to be filed with the registrar by the liquidator in a winding up, three rupees.

CHAPTER VI.

The Articles of Association

Their Registration

We have already seen that the memorandum of association of a company is its charter, whereas, the articles of association form the bye-laws, or regulations, which govern its internal management and embody the powers of the directors and officers of the company, as well as those of shareholders or members of the company as to voting, etc. The articles, unlike the memorandum, can be altered by special resolutions, but the alterations should be restricted within the scope of the company's powers as laid down by its memorandum (*Allen* v. *Gold Reefs of W. Africa*, (1900) 1 *Ch.* 656). This statutory right to alter its articles is one from which the company cannot by any device contract itself out (*Malleson* v. *National Insurance and G. Cor.*, (1894) 1 *Ch. D.* 200). In case a company does not possess a special set of articles of its own, the regulations as laid down, in Table "A," which is a Schedule attached to the Companies Act, shall apply. It is further provided that in case of companies registered with a special set of articles if the said articles are silent on some points, the provisions or regulations contained in the Table "A" shall apply to the same extent as if they were embodied in its own articles unless in the articles specially framed there is a clause expressly excluding the Table "A" as is usually done. It must however be noted that in the case of a company limited by guarantee, or unlimited companies, the articles of association must be registered with the memorandum of association. [S. 17 (1)]. There are also instances where companies do not file a special set of articles, but draw out a set of regulations embodying special powers which they wish to reserve.

and file same with a declaration to the effect that "Table 'A' shall be the articles of association of this company except in so far as they are modified by the following rules." The bulk of the companies, however, prefer to be registered with a special set of regulations and expressly exclude Table A with a special clause such as "The regulations contained in the Table marked 'A' in the first schedule to the Indian Companies Act, 1913, shall not apply to this company." There is one other form, which does not totally exclude Table A, *viz.* "The regulations in Table A in the first schedule to the Indian Companies Act, 1913, shall not apply to the company, except so far as the same are repeated or contained in these articles." Where however a special set of articles is prepared according to S. 17(2) of the Indian Companies (Amendment) Act, 1936, *they must contain or in any event shall be deemed to contain regulations, identical with or to the same effect as clauses 56, 66, 71, 78, 79, 80, 81, 82, 95, 97, 105, 107, 112, 113, 114, 115 and 116 of Table A. In case however of clause 78 it shall be deemed to be included in the articles of any private company except a private company which is the subsidiary company of a public company. In case of clause 107 it shall be deemed to require that a statement of the reasons why of the whole amount of any item of expenditure which may in fairness be distributed over several years, only a portion thereof is charged against the income of the year shall be shown in the profit and loss account unless the company in general meeting shall determine otherwise.* It may be further added that in the case where articles are not registered, the memorandum has to be endorsed "Registered without articles of association." Care should be taken to stamp the articles of association before they are executed and dated. (Art. 10 Schedule Indian Stamp Act, 1899). The articles of association of bodies formed not for profit need not be stamped. In cases where articles, though improperly stamped, were registered and acted upon for years they were held to be effectual (*Ho-*

Tung v. *Man On Insurance Co., Ltd.,* (1902) *A. C.* 232 (*P. C.*); *Kunj Kishori* v. *Porter,* (1914) 36 *All.* 416). Articles should be printed, paragraphed, numbered consecutively and signed by each subscriber to the memorandum of association *who shall add his address and description.* (S. 19).

Their Preparation and Legal Effect

We have noticed that care has to be taken to see that the regulations provided for in the articles do not exceed the powers of the company as laid down by its memorandum (*Ashbury* v. *Watson,* (1885) 30 *Ch. D.* 376); nor should there be any provision contrary to the Act (*Ashbury R. Carriage & Iron Co.* v. *Riche,* (1875) *L. R.* 7 *H. L.* 653); nor should they violate the provisions of the Companies Act, *e.g.,* if a company were to take powers in the articles to issue shares at a discount otherwise than in the manner authorised by the Act buy its own shares, or to pay dividend out of capital, such powers are void under the Companies Act. See (*Welteon* v. *Saffery,* (1897) *A. C.* 299; *Canji* v. *Colaba Press Co.,* (1912) 14 *Bom. L. R. p.* 521) *also Trevor* v. *Whitworth,* (1888) 12 *App. Cases* 409; *Guinness* v. *Land Corporation of Ireland,* (1883) 22 *Ch. D.* 349; also to limit the right of a member to present a winding up petition (*Re. Peveril Gold Mines Ltd.,* (1898) 1 *Ch.* 122 *C. A.*; to feter the company's power to alter the articles (*Malleson* v. *National Insurance & Guarantee Cor.,* (1894) 1 *Ch.* 200). In the words of Cairns, L. J. in *Ashbury Railway Carriage and Iron Co.* v. *Riche,* (1875) *L. R.* 7 *H. L.* 653 *at p.* 653 :—

"The memorandum is...........the area beyond which the action of the company cannot go; inside that area the shareholders may make such regulations for their own government as they can fit."

But an article which is in accordance with Table "A" but at variance with Act is valid as Table "A" has statutory authority (*Lock* v. *Queensland I. L. M. Co.,* (1896) *A. C.* 461).

The actual language of Section 17 runs as follows :—

(1) There may, in the case of a company, limited by shares and there shall, in the case of a company, limited by guarantee or unlimited, be registered with the Memorandum, Articles of Association signed by the subscribers to the Memorandum and prescribing regulations for the company.

(2) Articles of Association may adopt all or any of the regulations in Table A, in the First Schedule *and shall in any event be deemed to contain regulations identical with or to the same effect as regulation* 56, *regulation* 66, *regulation* 71, *regulations* 78, 79, 80, 81 *and* 82, *regulation* 95, *regulation* 97, *regulation* 105, *regulation* 107 *and regulations* 112, 113, 114, 115 *and* 116 *contained in that Table* :

Provided that regulation 78 *shall not be deemed to be included in the articles of any private company except a private company which is the subsidiary company of a public company* :

Provided further that regulation 107 *shall be deemed to require that a statement of the reasons why of the whole amount of any item of expenditure which may in fairness be distributed over several years, only a portion thereof is charged against the income of the year shall be shown in the proportion account unless the company in general meeting shall determine otherwise.*

(3) In the case of an unlimited company or a company limited by guarantee, the Articles, if the company has a share-capital, shall state the amount of share-capital with which the company proposes to be registered.

(4) In the case of an unlimited company or a company limited by guarantee, if the company has not a share-capital the Articles shall state the number of members with which the company proposes to be registered, for the purpose of enabling the registrar to determine the fees payable on registration.

The articles must be printed and divided into paragraphs. The paragraphs must be numbered consecutively. Each subscriber to the memorandum of association must sign these articles adding his address and description in the presence of at least one witness who must attest his signature (S. 19). The next point to be noted in connection with the articles is, both the memorandum and articles bind the company and its members as if they had signed and sealed a covenant.

Section 21 lays down that :—

(1) The memorandum and articles shall, when registered, bind the company and the members thereof to the same extent as if

they respectively had been signed by each member and contained a covenant on the part of each member, his heirs, and legal representatives, to observe all the provisions of the memorandum and the articles, subject to the provisions of this Act.

(2) All money payable by any member to the company under the memorandum or articles shall be a debt due from him to the company.

The above section by implication makes the memorandum as well as the articles carry a binding effect of a *covenant* between the company on the one hand and the shareholders or members on the other (*Bradford Banking Co.* v. *Briggs Son & Co.,* (1886) *L. R.* 12 *A. C.* 29; *Welton* v. *Saffery,* (1897) *A. C.* 299; *Imperial Hydropathic Hotel Company, Blackpool* v. *Hampson,* (1883) 23 *Ch. D.* 1). It may be added that an article providing for the reference of disputes to arbitration is a sufficient submission in writing within the Arbitration Act, 1889. Ashbury J. after considering all the cases dealing on this point concludes that

> "The result of these decisions is, I think, that if the submission is in writing and binding on both parties as their agreement or as the equivalent in law to an agreement between them the statute is satisfied." (*Hickman* v. *Kent or Romney Marsh S. Association,* (1915) 1 *Ch. D.* 881 *at p.* 902).

It should, however, be noted that these regulations bind only the members to their company and *vice versa.*

There is no doubt here that a member in his capacity as a member can enforce rights given to him by the articles such as impeaching any irregular forfeiture (*Johnson* v. *Lyttle's Iron Agency,* (1877) 5 *Ch. D.* 687); or prevent the company by an injunction restraining it from contravening the articles (*Wood* v. *Odessa Water Works Co.,* (1889) 42 *Ch. D.* 636); insist upon the strict observance of the articles according to its construction, *e.g.,* where the articles laid down that dividends were to be paid to the members in proportion to their shares it was held that the attempt to pay dividend to each shareholder in proportion to the amount paid-up on shares was incompetent

as articles provided for dividends being declared on shares in proportion, which meant that all shares were entitled to participate equally in dividend, without regard to the amount paid-up on each (*Oakbank Oil Co.* v. *Crum*, (1883) 8 *A. C.* 65); and in another case it was held that where articles provided that each member was entitled to a share certificate, in case of failure by the company to comply with that any member so aggrieved could force *the company to carry* out this requirement provided for in the articles (*Burdett* v. *Standard Exploration Co.*, (1899) 16 *T. L. R.* 112; *Hickman* v. *Kent or Romney Marsh Sheep Breeder's Assn.*, (1915) 1 *Ch. at p.* 881). But an outsider who is not a shareholder, or a shareholder in a capacity other than that of a shareholder shall not be entitled to claim the benefit of this section, *e.g.*, in one case, where the articles of association provided that a particular person, say E, should be employed as a solicitor for life, *i.e.*, he could not be removed for his life-time except for misconduct. E actually acted as such a solicitor for some time. Later on, the company removed him and employed some other solicitor. E brought an action for breach of the contract and lost on the ground that the clauses in the articles did not form a contract between him as a solicitor, *i.e.*, in his capacity as a non-member and the company. Lord Cairns, in the course of his judgment said :—

"The articles of association, as is well-known, follow the memorandum which states the objects of the company, while the articles state the arrangement between the members. They are in agreement *inter socio*, and in that view, if the introductory words are applied *to Article 118 which was the clause in the* disputed articles of the association, it becomes a covenant between the parties showing that they will employ the plaintiff. Now, so far as that is concerned, it is *res inter alios acta*, the plaintiff is no party to it. No doubt, he thought that by inserting it he was making his employment safe as against the company; but his relying on this view of the law does not alter the legal effect of the articles. The articles is either a stipulation which would bind the members or else is a mandate to the directors. In either case it is a matter between the directors and shareholders, and

not between them and the plaintiff" (*Eley* v. *The Positive Govt. Security Life Assurance Company, Limited*, (1876) 1 *Ex. D.* 20).

In connection with this case Mr. Stiebel in his book on *Company Precedents*, Vol. 1, (Edn. 3rd) p. 92 says :—

"Why should not the solicitor in that case have said, as I am a member, I insist that the legal business of the company shall be conducted in the manner provided by the articles, until they are altered the company has no power to have it conducted otherwise, and I am entitled to stand on the contract between myself in my character of member, and the other members. If he had taken this line his position would surely have differed little from that of the director in *Imperial Hydropathic Hotel Co.* v. *Hampson*, (1883) 23 *Ch. D.* 1. If this line had been taken it would have been very difficult for the Court to have decided the case as it did, on the ground that any contract there was, was *res inter alios acta*."

The corresponding Indian case is the *Ahmedabad Jubilee Mills Company* v. *Chottalal Chhaganlal*, (1908) 10 *Bom. L. R.* 141. Under the same principle it was held in the case of *Rotherham Chemical Company*, (1884) 25 *Ch. D.* 103, where the promoters engaged a solicitor to assist them in the course of the promotion and in the articles of the company it was laid down that all the expenses incurred in the course of the promotion of the company shall be paid by the company, it was held that in spite of such a clause, the promoters and the solicitor could not recover the expenses. This is so irrespective of the fact that the outsider who sues the company, depending on a clause in the articles as in the above case, happens to be a shareholder also. See also *Melhado* v. *Eorto Allegre Co.*, (1874) *L. R.* 9 *C. P.* 503. When the articles, as they usually do, provide that on incorporation the company shall enter into an agreement with a vendor for purchase of property or otherwise, the vendor who is a shareholder also, cannot sue on the articles to enforce this provision in the articles (*Pritchard's Case*, (1873) 8 *Ch. Ap.* 956; *Browne* v. *La Trinidad*, (1888) 37 *Ch. D.* 1). The articles may evidence the terms of a contract if subsequently acted upon by the parties (*Re. City Equitable*

F. I. Co., (1925) *Ch.* 407; *Isaac's Case*, (1892) 2 *Ch.* 158; *Molineaux* v. *London B. & M. Ince. Co.*, (1902) 2 *K. B.* 589; *Salton* v. *New Beeston Cycle Co.*, (1899) 1 *Ch.* 775).

The rule in the above para. has been followed in some cases in the interest of justice and though the articles were not specifying the rights of a member as a member, but where it is stated that a particular contract or covenant between the company and an outsider is to be entered into between him and the company and if thereafter such contracts were acted upon, the Courts have treated same as if they had actually made the contract in the terms of the relevant clauses. Directors were thus held to be entitled to their remuneration as provided for in the articles because this provision was considered as an implied contract (*Swabey* v. *Port Darwin Gold Mining Co.*, (1889) 1 *Meg.* 385; *Re. International Cable Co., Ex-parte, Official Liquidator*, (1892) 66 *L. T.* 253; *Ex-parte, Beckwith*, (1898) 1 *Ch.* 324). The principle is of equal application to outsiders as well as members (*Salisbury Jones & Dale's Case*, (1894) 3 *Ch.* 356; *Isaac's Case*, (1892) 2 *Ch.* 158).

It is further laid down that every person who deals with the company is expected to be familiar with the contents of its articles of association and ought, therefore, to know what limitations are laid down there (*Royal British Bank* v. *Turquand*, (1856) 6 *E. & B.* 327; *Fountaine* v. *Carmarthen R. Co.*, (1868) *L. R.* 5 *Eq.* 316; *Irvine* v. *Union Bank of Australia*, (1877) 2 *Ap. Cas.* 366; *Pierce* v. *Jersey Waterworks Co.*, (1870) *L. R.* 5 *Ex.* 209; *Mahony* v. *East Holyford Mining Co.*, (1875) *L. R.* 7 *H. L.* 869). This is said to be the rule of constructive notice as to the contents of the memorandum and articles. The Companies Act also has made provision under Sec. 248(5) to the effect that "any person may inspect the documents kept by the registrar on payment of such fees as may be appointed by the Local Government not exceeding Re. 1 for each inspection." In view of this it is not at all inequitous to state that any person who deals with the company has a right to inspect the memorandum

and articles of association of that company and therefore is supposed to know their contents. This principle was accepted long ago (*Ernest* v. *Nicholls,* (1857) 6 *H. L. C.* 401; *Cambell's Case,* (1873) 9 *Ch.* 1). The principle goes further than this and assumes that not only is the person supposed to be aware of the contents of these documents but the inference is that he is also taken to have understood them according to their correct meaning at law (*Griffith* v. *Paget, No.* 2, (1877) 6 *Ch. D.* 511; *Oakbank Oil Co.* v. *Crum,* (1883) *L. R.* 8 *A. C.* 65). Arising from this inference it would naturally follow that the person having read the contents of the memorandum and articles is taken to be aware of all the powers of the board of directors as well as shareholders' meeting and all other incidents which these documents cover. It is at the same time laid down that persons dealing with the company are entitled to assume that the articles are duly registered and legally adopted (*Muirhead* v. *Forth and North Sea Association,* (1894) *A. C.* 78); see also (*Hope Mills Ltd.* v. *Sir Cowasji J. Readymoney,* (1911) 13 *Bom. L. R.* 162), where it was laid down that

> "Outsiders dealing with the company are bound to acquaint themselves with its external position which can usually be gathered from the papers of their constitution, the memorandum of association and the article of association; but are not bound to inquire into and satisfy themselves upon all the details of the company's indoor management."

This rule was originally laid down in *Royal British Bank* v. *Turquand,* (1856) 25 *L. J. Q. B.* 327, *viz.,* that persons dealing with the company though bound to acquaint themselves with the articles and memorandum are not bound to inquire whether the officers of the company are regularly carrying out the requirements of these documents inside the office. In other words as *Lord Hatherley* said in this case they are not bound to look into the inside management and will be quite within their rights to assume that these officers did their duty regularly and observed all the regulations of the company. Thus

if the articles laid down that certain resolutions ought to be passed or certain steps are to be taken by the directors or others with a view to do a particular act, the outsider is not bound to make inquiries whether these regulations have been carried out in the office. Thus, as in the above case of *Royal British Bank* where the articles laid down that the borrowing can be done with the sanction of the general meeting it was held that the party who lent money need not make enquiries whether such sanction was obtained. A mortgagee can thus assume that a mortgage has been duly executed if it appears to be regular on the face of it (*County of Gloucester Bank* v. *Rudry M. S., etc., Co.,* (1895) 1 *Ch.* 629). In this case the question was whether the mortgage was sealed in an irregular manner as the directors sealed it at an irregular meeting. The mortgage was held good notwithstanding this fact with a view to protect the outsider. The same principle was laid down in *Duck* v. *Tower Galvanizing Co.,* (1901) 2 *K. B.* 314. The principle goes further and also enables the outsider to assume that the directors *de facto* who are carrying on the business of the company are directors *de jure* (*Mahony* v. *East Holyford Mining Co.,* (1875) *L. R.* 7 *H. L.* 869). Of course if the party knew that the internal regulations had not been carried out the position would be different (*Howard* v. *Patent Ivory Co.,* (1888) 38 *Ch. D.* 156). The rule also will not apply where the signatures to the document are forged (*Ruben* v. *Great Fingall Consolidated,* (1906) *A. C.* 439). In another case in dealing with this principle the Court held that the outsider is not bound to inquire into the internal management (*Bargate* v. *Shortridge,* (1855) 5 *H. L. Case* 297; *In Re. County Life Assurance Co.,* (1870) *L. R.* 5 *Ch. App.* 288; *In Re. Land Credit Co. of Ireland, Ex-parte Overend G. & Co.,* (1869) *L. R.* 4 *Ch. App.* 460). It is however held in *Re. Anglo-Austrian Printing and Publishing Union, Isaac's Case,* (1892) 2 *Ch.* 158), that the articles may indicate the terms upon which a member or an outsider, has agreed to deal with the company. In

this case the articles laid down that one Sir Henry Isaacs and others shall be first directors of the company and it was further laid down by the articles that the qualification of a director was to be the holding of shares, to the nominal amount £1,000. Sir Henry Isaacs had signed the memorandum and articles for one share of £10 and acted as a director, but he never applied for any shares nor were they allotted to him. He was also not registered as a member of the company. It was held that under these circumstances he may be taken to have agreed to take the qualification shares and pay for same. Again, it must be noted, in this connection that, by altering its articles, the company cannot break its existing contracts. In the words of *Vaugham William, L. J.* in *Allen* v. *Gold Reefs of West Africa,* (1900) 1 *Ch.* 656 :—

> "A resolution may alter the regulations of the company, but cannot retrospectively affect existing rights. I take it to be clear that the alteration must be made in good faith, and I take it that an alteration in the articles which involved oppression of one shareholder would not be made in good faith."

The effect of this decision is that the alteration, if effected for the benefit of the company as a whole, will be good, as long as the provisions of the memorandum are not exceeded. Of course, an alteration which is not *bona fide* and not in the general interests of all or is oppressive, will not be allowed, as for example, a majority attempting to commit a fraud on the minority.

The principle that the articles bind the shareholder to his company in his capacity of a shareholder was laid down by Buckley, J. in *Bisgood* v. *Henderson's Transvaal Estates,* (1908) 1 *Ch. at p.* 743 where his Lordship said that :—

> "The purpose of the memorandum and the articles is to define the position of the shareholder as shareholder, not to bind him in his capacity as an individual."

The extent to which the principle applies is very difficult to gauge and has not yet been settled. A general

discussion of this question is to be found in *Hickman* v. *Kent or Romney Marsh Sheepbreeders' Association*, (1915) 1 *Ch.* 881. Where the rights and liabilities of a shareholder are subject to a written agreement this agreement will be looked into (*Re. Alexander's Timber Co.*, (1901) 70 *L. J. Ch.* 767; *Re. City Equitable F. Insurance Co.*, (1925) *Ch.* 407 *at p.* 521). But a clause in the article either requiring the company to pay preliminary expenses, or imposing any other contractual obligation will not be enforceable unless there is a separate agreement (*Rotherham Chemical Co.*, (1884) 25 *Ch. D.* 103; *Empress Engineering Co.*, (1881) 16 *Ch. D.* 125; *Northumberland Avenue Hotel*, (1886) 33 *Ch. D.* 16).

We have already seen that the articles, as originally framed, should not be opposed to any provision of the Companies Act. In connection with the alteration of the articles, the same rule applies, and the alteration of an article in variance with the Act will be invalid and inoperative. In one case where the articles provided to the effect that a shareholder shall not present a petition to wind up the company except under certain circumstances, it was held that having regard to the section of the Act which specifically provides that such a petition may be presented " by any one or more contributory or contributories " the alteration was " really an attempt to fix upon the holder of average share, an obligation running with the share in contravention of the provisions of the Act," which a company had no right to enact (*In Re. Peveril Gold Mines Ltd.*, (1898) 1 *Ch.* 122).

Every company is bound to send to every member if so requested, a copy of its memorandum and articles of association. For this purpose the company may make a charge not exceeding one rupee per copy. The failure to comply with this request is likely to entail a fine on the company of not more than Rs. 10 for each offence. (S. 25).

The law requires that a copy of the registered articles must be furnished by the company to every member at

his request on payment of rupee one or such less sum as the company may prescribe. The same rule applies to the memorandum. If a company makes default in complying with this requirement it is liable, for each offence to a fine not exceeding Rs. 10 (S. 25). It is also further laid down that every modification, either in the articles or in the memorandum, effected later must be incorporated or embodied in every copy of such articles and memorandum, issued after the date of the alteration. In case of private companies the articles must include therein clauses which restrict the transfer of shares and limit the number of members *not including persons who are in the employment of the company* to 50 and prohibits any invitation to the public to subscribe for its shares if any or debentures. [S. 2, Clause 13 (*c*)]. The articles must not contain, in case of private companies, clauses authorising the issue of share-warrants. This point is further developed in a special Chapter on private companies, where the forms of articles restricting the transfer should be referred to.

Ultra Vires Articles

In the drafting of the articles care should be taken to see that powers which contravene the memorandum or the principles of company law are not taken. There have been cases where articles purporting to confer on the company the power to buy its own shares or to pay dividends out of the capital or to extend the objects by special resolutions have been declared void and ineffectual (*Trevor* v. *Whitworth,* (1888) 12 *A. C.* 409; *Guinness* v. *Land Corporation of Ireland,* (1883) 22 *Ch. D.* 349; *Ashbury* v. *Riche,* (1875) *L. R.* 7 *H. L.* 653). However, it has been held that if there happens to be an ambiguity in the memorandum, the articles which have been registered at the same time as the memorandum may be referred to, to solve or explain the same (*Southern Brazil Rio Grande do Sul Rly.,* (1905) 2 *Ch.* 78).

Alteration of the Articles

We have already seen that the articles of association can be altered by a special resolution. In this connection Section 20 lays down as follows:—

(1) Subject to the provisions of the Act and to the conditions contained in its memorandum, a company may by special resolution alter or add to its articles; and any alteration or addition so made shall be as valid as if originally contained in the articles, and be subject in like manner to alteration by special resolution.

(2) The power of altering articles under this section shall in the case of any company formed and registered under Act No. XIX of 1857 and Act No. VII of 1860 or either of them, extend to altering any provisions in Table B annexed to Act XIX of 1857, and shall also, in the case of an unlimited company formed and registered under the said Acts or either of them, extend to altering any regulations relating to the amount of capital or its distribution into shares, notwithstanding that those regulations are contained in the memorandum.

It may be added that Sec. 20A further provides that notwithstanding anything in the memorandum or articles of a company no member of a company shall be bound by an alteration made in the memorandum or articles after the date on which he became a member if and so far as the alteration requires him to take or subscribe for more shares than the number held by him at the date on which the alteration is made or in any way increase his liability as at that date to contribute to the share-capital of, or otherwise to pay money to the company. This of course does not apply where a member agrees in writing to be bound by the alteration. This section thus protects members from being saddled with the liability to take up or pay for shares or to an increased liability on their shares than that originally fixed through a special resolution. The only way in which they can be bound is by an agreement in writing taken from them.

Section 20 virtually speaking gives wide powers as far as alterations and additions go, and that too, without any sanction of the Court being necessary, the only check being the provision of S. 20A of the Act referred

to above and the terms of the memorandum. This power of alteration cannot be taken away from the members by a clause in the articles. In short a company cannot contract not to alter its articles (*Walker* v. *London Tramways Co.,* (1879) 12 *Ch. D.* 705; *Punt* v. *Symons,* (1903) 2 *Ch.* 506; *Malleson* v. *National Insurance & Guarantee Corporation,* (1894) 1 *Ch. D.* 200). The only limit if at all, to the alteration in the articles happens to be in the cases where (1) the alteration constitutes an oppression or fraud on the minority (*Brown* v. *British Abrasive Wheel Co.,* (1919) 1 *Ch.* 290); or where (2) the articles of association are being altered for the purpose of committing a breach of contract (*British Murac R. S. Limited* v. *Alperton R. Co., Ltd.,* (1915) 2 *Ch. D.* 186). It should however be remembered that when giving notice to members for calling a meeting with a view to alter articles of association, non-disclosures of important particulars in the notice would render the resolution giving effect to the alteration void. This is on the principle that there should be full and fair disclosure to the shareholders of the facts upon which they were asked to vote (*Narayanlal Bansilal* v. *The Manekji Petit Mills Co., Ltd.,* (1931) 33 *Bom. L. R.* 556). The alteration of the articles may be done with retrospective effect so long as the same is exercised for the benefit of the company as a whole (*Allen* v. *Gold Reefs of West Africa,* (1900) 1 *Ch.* 656). This is however subject to this that no majority of shareholders, by such alteration retrospectively, affect to the prejudice of non-consenting shareholders the rights which they already possess under the contract (*James* v. *Buena Ventura Nitrate G. Syndicate, Limited,* (1896) 1 *Ch.* 456, *at page* 466; *Welton* v. *Saffery,* (1897) *A. C.* 299 *at page* 309).

As to whether the majority can, by altering the articles, take away future rights of a class which are only attached by the articles is a very difficult question. The principle of general application is that as a shareholder is presumed to know that the rights conferred by the articles are subject to alteration provided by law, he

cannot complain unless he can show that the alteration sought to be effected is either (1) a breach of a separate contract made with him or with his class, or (2) that it is not made *bona fide* or for the benefit of the company as a whole (*British Equitable Assurance Co., Ltd.* v. *Baily,* (1906) *A. C.* 35 *per Lord Macnaghten, p.* 36). In case there is a mistake in the drafting of the articles, the correct course is to alter the articles under the powers given under the sections and not to apply to the Court to exercise its jurisdiction to rectify the mistake. It would only interfere to set right an injustice in case where a set of shareholders prevented the rectification of such a mistake wrongfully by their votes (*Evans* v. *Chapman,* (1902) *W. N.* 78).

On the question of alteration of the articles it was held in older cases that a contract outside the articles that the articles cannot be altered to deprive one of the parties to it of its contractual rights was not one that would deprive the company of its right to alter the articles (*Walker* v. *London Tramways Co.,* (1879) 12 *Ch. D.* 705); though it may give the aggrieved party a right to damages (*Punt* v. *Symons & Co.,* (1903) 2 *Ch.* 506). However *Sarjant, J.* in *British Murac Syndicate* v. *Alperton Rubber Co.,* (1915) 2 *Ch.* 186, (where the company had agreed that as long as a particular party held certain number of shares and had the right to nominate two directors the articles shall not be altered, the Court restrained the holding of the meeting to confirm the alteration) said :—

> "The decision of the Court of Appeal in *Baily* v. *British Equitable Co.,* (1904) 1 *Ch.* 374 (afterwards overruled in (1906) *A. C.* 35, though the proposition remained unaltered) therefore seems to one to be clear authority for the proposition that a company may be restrained by injunction from altering its articles of association for the purpose of committing a breach of a contract, one of the terms of which is that the articles shall not be altered."

The principle involved in connection with the alteration which cannot be departed from is that the alteration

as sanctioned by the Act has its limit, *viz.*, that it cannot be effected with a view to oppress or defraud a minority of members or shareholders, nor can it be altered in a manner which would violate any statutory provision or principle of law (*Peveril Gold Mines,* (1898) 1 *Ch.* 122; *Payne* v. *The Cork Co.,* (1900) 1 *Ch.* 308; *Menier* v. *Hooper's Telegraph Co.,* (1874) *L. R.* 9 *Ch. App.* 350) The principle that the articles cannot be altered with a view to break a contract or deprive any party of his contractual rights will apply to a contract with an outsider also (*British Murac Rubber Syndicate* v. *Alperton Rubber Co.,* (1915) 2 *Ch.* 186). Finally it should be remembered that the articles of association cannot be rectified by the Court for the simple reason that they have a statutory operation and the Court has no jurisdiction to do this (*Evans* v. *Chapman,* (1902) 86 *L. T* 381).

The important principle is that every shareholder is presumed to have purchased his shares with the full knowledge of the contents of the articles and thus cannot restrain their alteration even though to his prejudice (*Allen* v. *Gold Reefs of West Africa,* (1900) 1 *Ch.* 656). The only grounds open to him according to this case is that (1) the alteration would amount to a breach of his contract (*Hari Chandra Joga Deva* v. *Hindustan Co-operative Insurance Soc. Ltd.,* (1925) 52 *Cal.* 239); or that (2) it was not *bona fide* for the benefit of the company as a whole. This point has been fully dealt with under the heading of "Expropriation of a Shareholder." In cases where articles though not formally altered but have been acted upon for a long period the Court may treat them as regular (*Ho Tung* v. *Man On Insurance Co.,* (1902) *A. C.* 232). Even where there has been some defect in the method of adopting an article which is within the power of the company to adopt and contracts have been entered into on that footing, both the company and outsider may insist that it shall be binding on the parties where the contract

has been made on the basis of the article (*Muirhead* v. *Forth Insurance Co.,* (1894) *A. C.* 78). In one case where rights were conferred by articles on certain persons and it was sought to take away those rights from one of them by a special resolution without altering the articles it was held that that cannot be done (*Imperial Hydropathic Co.* v. *Hampson,* (1883) 23 *Ch. D.* 1). To sum up the principle is that even where the company cannot be prevented from altering its articles where there is a contract which has a bearing on the existing articles, it can be prevented from acting on its altered articles with a view to deprive the party of his contractual rights.

The alteration of the articles of association between application and allotment of shares was held not to invalidate the allotment (*English, etc., Rolling Stock Co., Re. Lyon's Case,* (1866) 35 *Beav.* 646). The Court has no right to rectify a mistake in the articles even though no shares were allotted because a document of this character has a statutory authority (*Evans* v. *Chapman,* (1902) 86 *L. T.* 381). In one case though the prospectus provided a reserve capital and the articles also provided for same, the Court allowed the article to be altered with a view to repeal this article (*Malleson* v. *National Insurance and Guarantee Corporation,* (1894) 1 *Ch. D.* 200). When articles are altered in connection with directors' remuneration a retrospective effect is never allowed to be given to them (*Swabey* v. *Port Darwin Gold Mining Co.,* (1889) 1 *Meg.* 385 *C. A.*). The articles cannot be altered to deprive the minority of its rights (*Brown* v. *British Abrasive Wheel Co.,* (1919) 1 *Ch.* 290). Those dealing with the company though expected to know the contents of the articles are not bound to see that the requirements are carried out and are entitled to assume that the requirements are properly carried out (*Land Credit Co. of Ireland,* (1869) 4 *Ch. App.* 460). Though the articles cannot alter the memorandum if there is an ambiguity in the memorandum, the same may be

explained by the articles registered at the same time (*Southern Brazil R. G. do Sul Rly.*, (1905) 2 *Ch.* 78).

PROCEDURE FOR ALTERATION

The secretary should first draft the resolution (where necessary in consultation with the company's lawyer) and get same approved by the board of directors. At this meeting he should also get a resolution passed authorising him to call the necessary meetings for the special resolution altering the articles to be considered. The notice calling the meeting must specify the material alterations effected by the altered article (*Normandy* v. *Ind, Coope & Co.*, (1908) 1 *Ch.* 84). After the necessary resolutions are passed a printed copy of the resolution signed by the chairman should be sent to the registrar for being registered and the new article should be inserted in every copy of the articles of association issued thereafter.

THE FORM OF NOTICE TO THE REGISTRAR OF JOINT STOCK COMPANIES OF THE ALTERATION IN THE ARTICLES OF ASSOCIATION.

THE INDIAN COMPANIES ACT OF 1913 SECTION 82 (1).

Special Resolution altering Articles.

THE BOMBAY SPINNING & WEAVING CO., LTD.,

To,

The Registrar of Joint Stock Companies, Bombay.

Sir,

The following is sent for the favour of registration under Section 82 (1) of the Indian Companies Act :

> "At an extraordinary general meeting of the members of The Bombay Spinning & Weaving Co., Ltd., held at the registered office of the company on 15th March, 1937 the following resolution was passed as a special resolution:—
>
> "Resolved that................(state the full text of the resolution here)."

Yours faithfully,

(Sd.) J. K. Kaka, *Chairman,*

The Bombay Spinning & Weaving Co., Ltd.

THE BYE-LAWS

Frequently articles grant powers to directors to "make, vary and repeal" bye-laws. So far as these bye-laws are to be made with reference to the servants of the company or its officers or conduct of business there is no objection to such a power. In case of regulations however, "for members" the best opinion is that they are "regulations for the company" and should therefore be passed by a special resolution.

THE USUAL CONTENTS OF THE ARTICLES OF ASSOCIATION

The following headings and brief remarks are a summary of what the articles usually cover. Most of these articles are dealt with fully in chapters under special headings dealing with the law and practice applying to them.

(1) The Exclusion of Table A

This is usually done in the following form :—"The resolution contained in the Table marked A in the First Schedule to the Indian Companies Act, 1913 shall not apply to the company." The title given to the above section of the articles is "Constitution of the Company." In some companies the following para. is also added, *viz* :— "But the regulations for the management of the company and for the observance thereof by the members of the company or their representatives, shall, subject to any exercise of statutory powers of the company in reference to the repeal or alteration of, or addition to, its regulations by special resolution, as prescribed by the Indian Companies Act, 1913, be such as are contained in these articles."

(2) Interpretations

These give a list of definitions of the various terms used in connection with the clauses in the articles.

(3) Preliminary

Under this heading, the articles contain clauses stating the preliminary agreements which the company proposes to make, or enter into, or adopt.

(4) Capital—Increase and Reduction

Here the various clauses dealing with the question of increasing of capital and powers connected therein are given. It is here laid down how and under what conditions additional new shares may be issued and the capital increased, whether the said shares have to be offered to the existing members and if so on what terms. The reduction of capital also is provided for under this section of the Companies Act as well as the power for sub-division. The boards of directors' powers as to allotment of shares, either out of the original capital offered to the public, or from the remaining unallotted capital at the time of registration, are also frequently added under this heading. Where shares of different denominations are issued by the company such as preference, ordinary, deferred, etc., this clause provides that all or any of the rights and privileges attached to the different classes of shareholders in the capital for the time being of the company may be modified, commuted, abrogated by agreement between the company and any person purporting to contract on behalf of that class, provided such agreement is confirmed by an extraordinary resolution passed at a separate general meeting of the holders of the shares of that class. It will thus be noticed here that the power to modify rights of shareholders is generally taken by our articles which is most desirable. This power to modify rights of course does not include power to extinguish rights (*Mercantile Investment Co.* v. *International Co. of Mexico*, (1893) 1 *Ch.* 484). The quorum for this meeting and other details as to the calling of this meeting, use of proxies, etc., are also dealt with under this clause.

(5) The Shares

Under this heading the clauses provide that shares should be numbered progressively or serially and lay down regulations as to the application and allotment of the same, issue of share certificates, renewal of such certificates, company's lien on shares, joint holding of shares and the rules applying to the joint-holders. Frequently the fact that no notice of trust or interest other than that of the registered shareholder is recognised is emphasised by a special clause. Rules as to voting and the notices as to the change of name and address of members are also dealt with here.

With reference to the allotment of shares the directors have to see that they act in good faith in the best interests of the company. The Court would naturally take it that the directors have so acted and the party aggrieved must affirmatively prove their case (*Ex-parte Penny*, (1873) 8 *Ch. App.* 446; *Percival* v. *Wright*, (1902) 2 *Ch.* 421; *Re. Coalport China Co.*, (1895) 2 *Ch.* 404; *Hannan's King and Co.*, (1898) 14 *T. L. R.* 314). Thus there is no objection to the directors making an allotment to themselves or to their friends so long as that is done *bona fide* in the interests of the company. They can even issue shares at par even though they could have sold at a premium (*Hilder* v. *Dexter*, (1902) *A. C.* 474). All that is got to be seen is whether that was done *bona fide* in the interests of the company. Failing that they will be guilty, of breach of trust (*Shaw* v. *Holland*, (1900) 2 *Ch.* 305).

In case of the article which refers to the notice of trust not being recognised the object sought to be achieved is not only to emphasise the rule laid down by the Act in Sec. 33, but also to relieve the company from the obligation of taking notice of the equitable mortgage of the share made by the shareholder. Thus the articles of some of the Indian Companies run as follows :—

Except only as is by these articles expressly provided, the

company shall not be bound by or recognise any contingent, future, partial or equitable interest in the nature of a trust or otherwise in any share, or in any other right in respect of any share, except an absolute right thereto, in the person from time to time registered as the holder thereof.

This was done with a view to meet the objection raised in *Bradford Banking Co.* v. *Briggs,* (1887) 12 *A. C.* 29 where the view as stated above was expressed. Also see *Societe Generale* v. *Walker,* (1886) 11 *A. C.* 20. Wherever the exemption clause exists the Courts generally hold that the company was entitled to disregard notice of equitable interests (*New London & Brazilian Bank* v. *Brocklebank,* (1882) 21 *Ch. D.* 302; *Miles* v. *New Zealand Alford Estate Co.,* (1886) 32 *Ch. D.* 266; *Re. Perkins,* (1890) 24 *Q. B. D.* 613). This is on the principle that a shareholder cannot both approbate and reprobate (*Borland's Trustee* v. *Steel Bros. and Co.,* (1901) 1 *Ch.* 288). However the jurisdiction of the Court to interfere in order to protect the rights of persons equitably interested remains (*Binney* v. *Insurance Hall Coal and Cannal Co.,* (1866) 35 *L. J. Ch.* 363; *Taylor* v. *Midland Rail Co.,* 8 *W. R.* 401). Thus many articles are now framed with the words " except as ordered by a Court of competent jurisdiction " with a view to show that the jurisdiction of the Court is not ousted. Thus the article reads as follows :—

Save as herein otherwise provided, the company shall be entitled to treat the registered holder of any shares as the absolute owner thereof and accordingly shall not, except as ordered by a Court of competent jurisdiction, or as by the Act required, be bound to recognise any equitable or other claim to or interest in such share on the part of any other person.

The law in connection with lien on shares has been fully dealt with under its appropriate heading. All that need be said is that articles specifically reserve this right of lien in spite of the fact that it has been said by some authorities that this right may be implied.

(6) Underwriting and Brokerage

Under the heading of underwriting and brokerage, the articles provide for the underwriting of shares, and lay down the rate of commission, or the maximum rate of same, as well as the rate of brokerage. This is done in connection with both shares and debentures and frequently in case of the debenture commission, the articles also reiterate that, in case the debentures are issued at a discount or any commission with respect to the issue is allowed the same shall, as required by Sec. 106 of the Indian Companies Act, 1913, be shown in the Balance Sheet of the company until the whole amount thereof has been written off. The articles must give the right to pay commission on issue or underwriting of shares and they must state the amount or rate of such commission and the commission agreed to be paid, if any, must not exceed the amount or rate so authorised. (S. 105).

(7) Interest out of Capital

Under this heading the clauses in the articles frequently provide for interest to be paid as provided for in Section 107 of the Indian Companies Act, 1913, in the case of capital raised to defray the expenses of construction of any works or buildings or the provision of any plant which cannot be made profitable for a lengthened period. This clause is necessary under Section 107(1) if the company intends to pay such an interest, as the said interest cannot be paid unless authorised by the articles or by special resolution. It may be added that here the previous sanction of the Local Government has to be obtained. The period for which such interest is payable is also determined by the Local Government and the rate of interest is in no case to exceed 4 per cent per annum.

(8) Transfer of Shares

This heading deals with the method, or procedure, by which shares are to be transferred or the circumstances

under which the same are transmitted. In the case of public companies the clauses usually provide for the maintenance of a "register of transfers," the actual form of transfer and the mode of its execution, the period of closing of the "transfer book," power of the board to refuse a transfer, the title to the shares in the case of a deceased shareholder, registration of persons entitled to shares otherwise than by transfer, the conditions of registration of transfer, fee payable on a transfer or transmission, prohibition of transfer to infants and frequently clause prohibiting foreigners from holding shares are also inserted where necessary. Powers are also reserved to the board to require evidence of transmission.

In the case of private companies special clauses have to be provided with a view to restrict transfer of shares to a non-member. Here usually the clauses provide that the shares are to be valued by a resolution either at a general meeting or by the board or by auditors of the company on certain computation as indicated in the articles and that the company undertakes to find a purchaser from among its own members within a specified time. If the purchaser is found, the member who wants to sell the shares has to transfer them. If he fails to do so the articles also give powers to the board to transfer these shares to the purchaser in spite of that, the money recovered by the sales being paid to the selling member. If on the other hand the company fails to find a purchaser within the time fixed by the articles the member desiring to sell the shares is authorised to sell and transfer same to any third party at any price he can get. Absolute discretion is also left to the directors here to refuse to register a transfer. Frequently the circumstances under which this power to refuse to register a transfer is to be exercised are enumerated by the articles.

(9) Calls on Shares

Here the board's power to make calls and the terms and conditions under which the same are to be made, the

term or period for the notice of call, the passing of the resolution making the call, are provided for and in some cases arrears of calls are also made to carry interest. The directors are also given in certain cases the power to extend time for paying of calls and frequently clauses are also to be found providing for the payment of calls in advance on which interest is made payable at a certain rate per cent. This last clause is nowadays dropped from the articles in the case of new companies.

(10) Forfeiture of Shares

Under this heading powers given to the board to forfeit shares, as we have seen elsewhere, cannot be exercised unless the articles specifically provide for same. Here the clauses as to forfeiture will contain the terms of notice to be given to the defaulting shareholder before a resolution of forfeiture is passed in due form. It is then laid down that the forfeited shares are to be the property of the company and may be sold by the same or reallotted or otherwise disposed of. A specific clause also provides that in spite of forfeiture the shareholder concerned is liable to pay the money owing at the time of forfeiture with or without interest. The rate of interest is also specified. Frequently a certificate of forfeiture in writing under the hands of two directors and countersigned by agents, or secretaries, is also provided for in the clause, which is delivered to the purchaser of such shares as evidence of his title to the said shares together with the new certificate of proprietorship. The directors are also frequently given powers by the articles to remit as a matter of grace and favour, the arrears on calls made on forfeited shares under certain circumstances. Clauses also are to be found under this heading empowering the directors to accept the surrender of shares by any shareholder desirous of surrender on such terms as the directors may think fit. Frequently a clause is inserted empowering the directors to annul forfeiture at any time before any share so forfeited has been sold, re-allotted or otherwise disposed of.

(11) Meetings of Shareholders or Members

Under this heading detailed clauses are to be found as to the first general meeting being held within not less than one month and not more than six months from the date on which the company is entitled to commence business, *i.e.*, statutory meeting, the holding of the annual general meeting and preparation of the annual list and summary and profit and loss account and auditor's report balance sheet together with directors and to be forwarded to the Registrar of Companies in accordance with Sections 131 and 134 of the Indian Companies Act, 1913, the extraordinary meetings and the provision for holding the same on requisition from shareholders, the period for which the notice of such meetings is to be given and by whom the said notice is to be signed, are all provided for. It is also reiterated in most cases by the special clauses in the articles that the omission to give notice to any of the shareholders, where the meeting has been previously advertised, shall not invalidate any resolution passed at any such meeting. The clauses also lay down what business must be notified in the notices and what need not be. A special clause provides for a quorum and adjournment. Generally it is provided that in case a quorum is not present at the first meeting and that meeting has to be adjourned therefore, at the adjourned meeting the shareholders present, irrespective of their number or the amount of the shares held by them, shall have the power to decide upon all matters which should properly have been discussed at the meeting from which the adjournment took place. Another clause lays down that the chairman of the board of directors shall preside at the meeting and in case of absence of that officer, the shareholders may appoint a chairman. The chairman's power to adjourn meetings has to be also carefully provided for. The order in which the motions are to be brought before the meeting and decided as well as the method of dealing with amendments are also detailed for easy reference and guidance of officers of the company as well as members. The demand for poll and the incident

connected therewith constitute a few special clauses in the articles.

(12) Votes of Shareholders

Under this most important heading the rights of members to vote or not to vote are laid down. Generally provisions are inserted preventing members in arrear in the payment of calls from voting. It is also open to the company at law to regulate by articles the right of voting of various classes of shareholders or members. Thus a member may be given one vote for every share held by him or he may be given one vote for 10, 50 or 100 shares. In case of certain class of shareholders such as preference shareholders, articles may, by special clauses, prevent the holders from voting altogether. The articles here deal with all these items as well as with the power of voting personally or by proxy, and the appointment and qualification of the proxy. Generally the condition applying to proxies provide that the same should be deposited by the company's office two or three days prior to the date of the meeting. A special clause frequently provides that the proxy will be valid notwithstanding the previous death of the member, if a vote has been given in accordance with the terms of the instrument, provided, that no intimation in writing of the death, revocation, or transfer shall have been received at the office before the meeting. It is also enumerated or emphasised, which is of course a rule of common law, that the chairman of the meeting shall be the sole judge of the validity of a vote tendered at such meetings. The articles also provide a special form of proxy which has to be used by applying for the same from the company.

(13) The Directors

This heading gives the most important information as to the powers delegated to the board of directors. Here the number of directors, including maximum and minimum as well as *ex-officio* directors if any, are stated and in some cases the " debenture directors " are also provided for.

If there is to be the appointment of any "alternate director" who is to fill the office during the absence of the original director from India, the same has also to be provided for by a special clause in the articles. This "alternate director" is generally given the right to receive the notice of meeting of the directors and to attend and vote there during the absence of the director in whose place he is acting, but he is made to *ipso facto* vacate the office if and when the original director returns. The directors are also given power to fill in vacancies and to add to their number. The articles also lay down the qualifications of directors, their remunerations, plus any extra compensation or remuneration to be given to him if he is not a *bona fide* resident of the centre at which the board meetings are to be held. The directors are also empowered to act notwithstanding any vacancy in their number. Where however their number falls below the minimum fixed the usual provision is that they shall not act except for the purpose of filling up vacancies. A special clause deals in detail as to the incidents and circumstances under which a director's office is to be vacated. The other important article and the most necessary one is that which gives powers to the directors to contract with the company. This clause is the most essential as in the absence of such a clause the director is disqualified by his office from contracting with the company unless such contract is disclosed to all members and is passed by a general meeting of the company. One other usual clause, and a most necessary one, is the provision for retirement of directors by rotation and the method by which this retiring of directors is determined. It may be added that it is now provided by S. 83B(2) of the Amending Act of 1936 that *notwithstanding contained in the articles of a company other than a private company not less than two-thirds of the whole number of directors shall be persons whose period of office is liable to determination at any time by retirement of directors by rotation.* This does not apply to old companies incorporated before the commencement of the

Amending Act of 1936. When the directors retire by rotation under the articles, the provisions empower the company to appoint others in their place, or to reappoint them if they like in case the retiring directors offered themselves for such re-election. Sometimes powers are also given to the company to remove directors, or increase or reduce their number. It may be added that under S. 86 (1) of the Amending Act of 1936 *a company may by extraordinary resolution remove any director whose period of office is liable to determination at anytime by retirement of directors in rotation, before the expiration of his period of office and may by ordinary resolution appoint another person in his stead. A director so removed shall not be reappointed a director by the board of directors.* The words " whose period of office is liable to determination " are included with a view to exclude *ex-officio* directors appointed by managing agents from the operation of this section. In case a new person is to be proposed in place of the retiring director the articles generally provide for a prior notice, in writing of about 7 to 15 days. A special clause reiterates the requirements of Section 87 of the Indian Companies Act, 1913, under which the register of directors has to be maintained giving the information as laid down by the section as well as the changes in their appointment from time to time.

(14) The Proceedings of Directors

Under this heading the clauses clearly specify how holding of the meetings of directors is to be regulated, also the intervals at which they are to be held, and how the questions raised at such meetings are to be decided. They also give powers to the board of directors to appoint committees and delegate certain work. Frequently the articles here give powers to the board to pass a resolution by circular instead of by holding a board meeting in specified cases. There is frequently a clause reiterating that the acts of the board or committees are to be valid, notwithstanding defects in the appointment of directors or members, or

in any other particular. There are also clauses stating the remuneration if any of directors as well as special remuneration (if any) payable for extra work. They reiterate the duty of keeping minutes of all proceedings of directors, the power to appoint a chairman by directors in board meetings in the absence of the regular chairman, etc. Here it should be noted that according to S. 17 (2) of the Indian Companies (Amendment) Act of 1936 *the articles of the company shall in any event be deemed to contain clauses identical with or to the same effect as clauses 71, 78, 79, 80, 81 and 82 of Table A as far as the clauses relating to directors are concerned, except that clause 78 with regard to retirement of directors shall not apply to private companies.*

(15) The Board of Directors

Under this heading clauses set out declaring the extent to which the directors can exercise the general powers of the company, certain specific powers are also enumerated in detail. Generally these specific powers relate to the payment of preliminary expenses, acquisition of properties and payment for the same, as well as for debentures, etc., securing of mortgages and contracts, appointment of officers, acceptance of surrenders, appointment of trustees, power to accept and hold any trust property for the company, to bring and defend actions, power to refer to arbitration, to give receipt, to authorise or sign on company's behalf bills of exchange, promissory notes and endorse them, draw and endorse cheques, and sign contracts and other documents, also power to appoint attorneys or agents on behalf of the company to invest money, to give security by way of indemnity, to create a reserve fund, to make bye-laws for the regulation of internal office arrangements, etc., to pay or allow dividends, bonuses from time to time on all shares, to delegate to any or more of them or to an outsider or outsiders any of the powers vested in them, to appoint and suspend managers, secretaries, clerks, agents and servants from permanent, temporary or special services,

to give to any such officer or other person employed commission on the profits of any business or transaction or a share in general profits, etc. Frequently powers are given in the case of companies having a business over a large area to establish " local boards " for managing the affairs of the company in any specified locality in India or out of India and to appoint persons to be members of such " local boards " and to fix their remuneration. Powers are given to these " local boards " to delegate from time to time their powers to any other person and also to fill up any vacancies.

(16) The Management of Business

As the Indian Companies are in a large number of cases under the management of a firm of managing agents this clause generally specifies that the general management of the company shall be carried on by such managing agents, subject to the control and supervision of the directors. In the case of managing agents being a firm it is also specified that the said firm or person, or persons who happen to be partners in them, and their successors in business, shall continue as such agents for the period specified in a special agreement by this firm of managing agents with the company. It may be noted that under an Indian Companies (Amendment) Act of 1936 *no managing agent shall be appointed to hold office for a term of more than twenty years at a time in case of companies incorporated after the commencement of the Act whereas in case of managing agents appointed before the commencement of the Act it is provided they shall not continue to hold office after the expiry of twenty years from the commencement of the said Act unless reappointed before the expiry of the said twenty years, notwithstanding anything contained in their agreement or articles of the company. (S. 87A)*. The managing agents are also given powers to sign receipts, cheques, etc., in the actual course of business, receive and pay moneys, etc. Managing agents are sometimes also given the powers under this clause to sub-delegate all or any of their powers, authorities and

discretions for the time being vested in them, in such manner as they may think fit. Power is given to the managing agents to work for and contract with the company. Frequently clauses are so drafted as to say that the firm of Messrs. X, Y & Z their successors, assignees or nominees shall be and are hereby appointed Secretaries, Treasurers and Agents of the company and the agreement entered into with them by the company is referred to, a copy of which is annexed to the articles. Here it may be added that the assignment or *transfer of his office by a managing agent is now void unless approved by the company in general meeting under S. 87B of the Amending Act of 1936*. Hence the draftsman should insert such a proviso in his draft of the said article as well as in the agency agreement. Even the rate of commission on net annual profits payable to these managing agents is included. Now under *S. 87C of the Amendment Act of 1936 only a fixed percentage of the net annual profits of the company with provision for a minimum payment in the case of absence of or inadequacy of profits together with an office allowance is all that can legitimately provided for in agency agreements entered into after the Amendment of the Act.* Articles also frequently provide for a compensation to be paid to managing agents for loss of employment as such agents, in the event of the winding up of the company, or that of the company ceasing to carry on business. Here it may be added that *no compensation will be payable where the winding up is due to the negligence or default of the managing agent* (*S. 87B Amending Act, 1936*).

(17) Dividends

Under this heading details are given as to how dividends are to be declared on different classes of share the company may have issued and the circumstances under which the said dividends may be postponed. In case the directors are to be empowered to declare an interim dividend the same is stated. Articles provide that a member indebted to the company is not to receive a dividend which the company is

given the right to use for reimbursing its claim. Frequently articles provide for the remittance of dividend warrant through the post and make it clear that the company will not be responsible in case the warrant is lost in the course of such transmission, and through that loss the member or person entitled to the dividend suffers loss through the endorsement on the said dividend warrant being forged. Some articles also empower the directors to declare and pay the dividend, *in specie, i.e.,* by distribution of specific assets, or paid-up shares or debentures. Some articles provide that in case of joint holders, signature of any one of them, frequently that of the first named joint holder of share will be sufficient authority for the company to pay the dividend. A clause is also frequently inserted providing that dividends unclaimed for one year after declaration shall vest in the company or may be made use of by the directors in any other manner for the benefit of the company. Frequently a three years' period is provided here.

(18) Accounts

Articles here reiterate that the directors are to keep proper accounts and indicate the manner in which the statement of accounts is to be furnished to general meetings. The Indian Companies (Amendment) Act, 1936 now provide for submission of *profit and loss account with particulars* as specified in S. 132(3); a balance sheet in the Form specified, *viz.,* Form F and *director's report* (S. 131A) to the shareholders of the company which may be reiterated in the articles by the draftsman.

(19) Audit

Under this heading the articles provide for the yearly audit of the company's books with a view to ascertain the correctness of the profit and loss account and balance sheet, the appointment and qualification of auditors, the mode of fixing their remuneration and the place where the company's books are to be kept. A clause frequently asserts

that the accounts, when audited and approved, are to be conclusive as to errors not discovered within three months. Some articles simply make a reference to the provisions of the Indian Companies Act, 1913 as to audits and auditors.

(20) Notices

A special heading of "notices" must now reiterate under the Indian Companies (Amendment) Act, 1936 the clauses 112 to 116 of the Table A as they are now compulsory.

(21) Winding up

Under this article it is usually laid down as to how the distribution of the surplus is to be made among members, after paying all creditors, and frequently, a special clause provides for the distribution of these assets among members *in specie* and lays down the conditions and circumstances under which that has to be done.

(22) Secrecy

Here the articles generally provide for trade secrets being maintained and lay down that no business secret or secret process can be disclosed to any member.

(23) Arbitration

Frequently a clause is added to the Articles to the effect that if any difference shall arise between the company and any of the members, or their representatives, touching the construction of any of the Articles or any act or thing in regard to the rights and liabilities arising thereto, or out of the relations existing between the parties, the same shall be referred to arbitration either of special arbitrators appointed by the parties or some special officer such as the president of the chamber of commerce.

(24) Miscellaneous Clauses

Dealing with sealing, winding up, arbitration, etc., which we shall deal with later on.

CHAPTER VII

Private Companies

Their Origin and Definition

Private companies were first introduced in India by our Companies Act of 1913. In England, before the passing of the Companies Consolidation Act of 1908, the term "private company" indicated those companies which did not offer their shares to the public at the time of incorporation. In other words, any company whose shares were privately subscribed for, came under that designation. This did not work satisfactorily because shares originally issued privately, began to be sold in the market and thus the requirements as to the prospectus, etc., could be easily avoided by an original private issue. Thus, the Companies Consolidation Act of 1908 of England divided companies under two distinct heading *viz.*, "Private" and "Public." The first, namely a private company, was strictly restricted to the membership of fifty as we shall see presently, whereas the second, namely, a public company had to be incorporated with a membership of at least seven, though in this case the maximum number was left unlimited. Besides this, publicity is particularly insisted upon in case of public companies, and the promoters are compelled either to issue a prospectus to the public, or to file a statement in lieu of prospectus. Thus according to the definition of our Indian Companies Act of 1913, Section 2(13) a "private company" means a company which :—

(1) by its articles,

(a) restricts the right to transfer the shares *if any;* and

(b) limits the number of its members to fifty *not including persons who are in the employment of the company;* and

(c) prohibits any invitation to the public to subscribe for shares *if any*, or debentures of the company;

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purpose of this definition, be considered as a single member.

It may be further noted that associations not for profit, companies limited by guarantee, and unlimited companies which have no share-capital cannot be incorporated as private companies, as restrictions required to be imposed in connection with transfer of shares cannot be provided for in the articles. The private character of the company may be terminated as soon as any of the above restrictions are removed or on commission of any default in connection with the observance of them.

Exemptions and Privileges

It will be seen from the above that there cannot be less than two members, nor more than fifty, *not including* persons who are in the employ of the company, in case of a private company, and that, such a company should not make a public offer of shares. The privileges enjoyed by these private companies comprise of the following exemptions :—

(1) They need not file a statement in lieu of prospectus.

(2) They can commence business and exercise borrowing powers as soon as they are incorporated and need not comply with the other requirements enforced from public companies.

(3) They are not to forward a statement in the form of a balance sheet to the Registrar.

(4) No reports are required to be filed by them as in the case of public companies.

(5) Their profit and loss account and balance sheets need not be audited and certified by auditors of requisite qualifications as is the case under the Indian law with public companies. In English law any one irrespective of his qualifications can be an auditor in both public and private company.

(6) The requirements as to "minimum subscription" do not apply to them.

(7) They are free from the requirements with regard to the

appointment of directors by the articles, as well as their consent to act as such, and to take up and pay for the qualification shares, if any, as applying to public companies.

(8) They are not required by law to file their annual profit and loss account and balance sheets with the registrar, but they are required to disclose the amount of the paid-up capital and their indebtedness secured by mortgages and charges.

(9) Though they must hold the statutory meetings they are not to file their statutory report with the registrar.

A private company in other respects has to comply with the requirements of Companies Act applying to companies in general. These may be summarised as:—

(1) An annual list and summary must be submitted to the registrar (Sec. 32).

(2) The register of members must be maintained which should be open for inspection to the public (Secs. 31—36).

(3) The register of directors and mortgages and charges must be maintained (Secs. 87, 109).

(4) Annual general meeting as well as the statutory meeting must be called (Secs. 76, 77).

(5) Its accounts must be audited though not by an auditor of requisite qualification (Sec. 144).

(6) According to the requirement of Sec. 135 it must furnish every member with copies of the balance sheet *and the profit and loss account or the income and expenditure account* and the auditor's report on payment of the specified charge.

To put it briefly, a private company, with certain exceptions, is subject to the requirements of the Indian Companies Act, 1913. In the words of *Lord Macnaughton* in *Trevor* v. *Whitworth*, (1888) 12 *App. Cases* 409. "A family company whatever the expression means, does not limit its trading to the family circle. If it takes the benefit of the Act, it is bound by the Act as much as any other company. It can have no special privileges of immunity."

On this principle it was laid down in *Re. George Newman & Co.*, (1895) 1 *Ch. D.* 674 that the directors cannot pay themselves or make presents to themselves out

of a company's assets which are not authorised by the shareholders or by the interests regulating the company. As per *Lindley, L. J.* "A registered company cannot do anything which all its members think expedient, and which, apart from the law relating to incorporated companies, they might lawfully do. An incorporated company's assets are its property and not the property of the shareholders for the time being and if the directors misapply those assets by applying them to purposes for which they cannot be lawfully applied by the company itself, the company can make them liable for such misapplication as soon as anyone properly sets the company in motion."

Their Advantages and Utility

The private company arrangement makes it possible for advantages of limited liability being provided for in the case of an enterprise where a limited number of partners wish to control the whole establishment and provide for complete capital. Here, the privacy of the business affairs, as well as the limitation of the liability is provided for, and the death, or retirement, of a member does not, as in the case of a partnership, put an end to the existence of the company. In short, the advantages of a private partnership are maintained side by side with the addition of the privilege of the limitation of liability. From this, it must not be thought that any unlimited liability company cannot be registered as a private company. It should however be remembered that unless a company has a capital divided into shares it cannot be registered as an association not for profit, a company limited by guarantee or an unlimited company.

The other advantage afforded by a combination of this character is that, in case where the head of a partnership firm who is holding the bulk of the capital, retires, he may convert the partnership firm into a private limited company, retaining a substantial interest in the fortunes of the enterprise by holding a large capital in the company,

and at the same time relieve himself from the anxiety of being liable to his last penny to the creditors of the company in case of a subsequent failure. It also enables parties to launch into risky enterprises, because, they can limit their stakes as well as participate in the working of the concern. In case of a family business, the owner may safely retire, or take it easy, by converting his firm into a private limited company, leaving his sons and trusted old servants to look after it. He knows his actual stake in the enterprise and feels secure as to the balance of his saving. Thus the old business is run on the same old lines, by men experienced and interested, under the fostering care and general supervision of its parent. Again, a private firm cannot claim a monopoly with respect to its name which is here secured through incorporation as a private company. Though the number of members is here limited there is no limit as to the amount of capital. In England, in fact, there are thousands of private companies in existence with capitals ranging from pounds one hundred to one million. It is also open to private companies to raise loans and borrow money through the medium of debentures besides borrowing in the other forms open to trading companies. According to Sir Francis Palmer, (under Sec. 105 of our Indian Act), it will be possible for a private company to pay a commission for subscribing or agreeing to subscribe for or procuring subscription of shares as for this purpose there cannot be a public offer. The other advantage is the facility which generally joint stock companies enjoy in connection with borrowing. Besides borrowing on the same footing as an ordinary firm of sole owner or partnership, a company can issue debenture bonds. This form of borrowing has many advantages peculiar to them. Here by issuing debentures in small values a substantial amount can be raised if the company commands a credit. In fact past experiences have proved that people and even traders are too ready to give credits to joint stock companies and have frequently landed themselves in trouble by losing on careless invest-

ments. The facility afforded by debentures to its holders is a great attraction. They can be conveniently sold or transferred and when due can be easily enforced in a Court of Law. They are generally secured by a mortgage of the company's assets and are thus a safe investment particularly when the mortgage is a fixed mortgage. The other advantage is that unlike partnership where if a partner lends money to his firm he is postponed until all the other creditors of the firm are paid in full, a member of a joint stock company can by purchasing debentures become a creditor of the company with an equal right to share in the assets of the company in liquidation with creditors of the same degree or class. Thus a private firm can secure a larger scope for securing additional capital for its business as a private company by issuing shares with varying rights as to the sharing of profits, voting, etc., or by issuing of debentures as we saw above which it cannot do as a private firm. In cases of public companies articles generally restrict the borrowing powers of directors but private company articles generally do not, as this check is in the majority of cases not necessary on the powers of directors, who here are the proprietors holding almost all the shares.

There are also cases where a number of firms carrying the same type of business have found it advantageous either to combine into one private company holding proportionate capital and thus eliminate competition or they arrive at the same result by converting each of them into so many separate private companies, working in a sort of union or combine, pooling and dividing the profits along agreed lines.

In the case of a partnership though the powers of individual partners may be limited by the partnership agreement, the outsider who deals with the firm, unless he is told of the limitations (which in practice is never done) is entitled to take it for granted that every partner has complete powers implied by partnership law and enter into agreement which may put the firm into a loss. His

brother partners are liable to make good this loss, though the partners responsible for the agreement may have exceeded his contractual powers as a partner and may not be able to recover this loss from the guilty partner in case he is financially weak. In case of a private company however the directors are tied down by the limitations of their powers by the articles and what is still better is that every outsider who deals with the company has the onus thrown on him to make himself acquainted with the contents of the articles before dealing with the company. He cannot thus plead ignorance of the powers of the directors in case the same are exceeded in connection with his agreement with the company.

The complications arising in the position at law in case of death, lunacy, insolvency, retirement, etc., of partners in a partnership are all unknown to a company combination and that is one more attraction for it to be converted into a private company. The transfer or assignment or mortgage of his share by a partner involves the firm, at the instance of his brother partners, into a dissolution. All these can be done with the shares held by principal partners in the company without involving any serious legal incident.

Under this arrangement a concern can take in as many investing or financing or sleeping partners as they like without burdening these parties who do not take any managing part in the concern the burden of unlimited liability. This advantage is in itself great in inducing people with capital to invest without hesitation, by purchasing shares and sharing profits without risking the burden of unlimited losses and the consequent liability in case of failure and dissolution. The customers and the employees can also here be made to purchase shares and thereby become interested in the success and prosperity of the concern.

In private companies the principal members holding the bulk of the capital are generally appointed, by the articles and the agreements "life directors," or permanent

directors, the principal members are also frequently styled managing or governing directors.

In case of businesses of a speculative nature, if they are run under a private limited company organization, the owners can lay aside the profits, without running the risk of being called upon to disgorge same to make good losses. On the same basis when the owner of a profitable business dies and the sons cannot, for one reason or other, attend to the business they can, instead of winding same up, convert it into a private limited company and permit the experienced officers of the firm to carry same on without shouldering unlimited risk.

There are cases where a profitable business finds itself in temporary monetary difficulties and forcing of the hands of its proprietors is likely to cause losses to the creditors. Here a conversion of same into a private company is the best solution to the interest of all, the smaller company with secured debentures issued to the larger creditors to be redeemed within specified period and a certain amount of control in management has proved satisfactory, creditors being either paid debentures or cash as may be arranged.

There are occasions when a syndicate is formed either to do some cornering of a commodity or other equally risky business the syndicate finds it best to don the garb of a private limited company.

The private company is on the same footing as a public company on the question of issue of preference, ordinary and founders or deferred shares as well as "reserve capital."

In India a good number of managing agency firms have converted themselves into private limited companies for personal safety.

UNDERWRITING COMMISSION

It should be noted that under Sec. 105 of the Indian Companies Act a private company can pay underwriting commission as well as a public company because the

section applies to both these classes (*Dominion of Canada General Trading and Investment Syndicate* v. *Brigstocke*, (1911) 2 *K. B.* 648). Under Indian Companies Rules 1914, the Form VIII is prescribed, which has to be used where shares are not offered for public subscription in case of a public company and also in case of all private companies and the amount or rate of commission has to be disclosed which has to be signed by all the directors and filed with the registrar. The statement should be filed before payment is made for safety as the language of the Act on this point is rather ambiguous. The English Act has got a similar provision and the form prescribed under the rules of the English Act explains that the object of filing of this statement is to remove doubts as to whether a vendor to or promoter of or other person who receives payment in money or shares from a company has, and always has had, power to apply any part of the money or shares so received in payment of any commission, the payment of which if made directly by the company would have been legal under the Companies Act (*See W. N.*, (1908) 11th *July, page* 223). The form as prescribed is as follows :—

FORM VIII.

STATEMENT AS TO COMMISSION WHERE SHARES ARE NOT OFFERED TO THE PUBLIC.

The Indian Comanpies Act, 1913.
(See Section 105)

Filing fee Rs. 3.

Presented for filing by ....

Statement by a Company, pursuant to Section 105 of the Indian Companies Act, 1913, of the amount or rate paid or agreed to be paid, by way of commission in respect of shares.

Name of Company	No.
Article of Association authorising commission	
Particulars of the amount paid or payable as commission for subscribing or agreeing to subscribe or procuring or agreeing to procure, subscriptions for any shares in the company	Paid Rs. Payable Rs.
or	
Rate of such commission	Rate per cent.
Date of circular or notice, if any (not being a prospectus), inviting subscriptions for the shares and disclosing the amount or rate of the commission	Date.

Signature of the Directors or of their agents authorised in writing.

Date.

Annual List and Summary

The Annual List and Summary as required by Sec. 32 of the Indian Companies Act, 1913 must be prepared and filed with the registrar in case of private companies also *within eighteen months from its incorporation and thereafter once at least in every year.* The details as to this statement are given later. (*See* index). The failure to file the list in time *i.e., within twenty-one days after the day of the first or only general meeting of the year* entails a fine not exceeding fifty rupees for every day during which the default continues and every officer of the company who knowingly and wilfully authorises or permits the default shall be liable to the like penalty.

Under new *sub-section (4) of Section 32 added by the Indian Companies (Amendment) Act of 1936 a private company must send with the annual return a certificate signed by a director or other officer of the comanpy that the company has not, since the date of the last return or, in the case of a first return, since the date of the*

incorporation of the company, issued any invitation to the public to subscribe for any shares or debentures of the company, and whereas the annual return discloses the fact that the number of members of the company exceeds fifty, also a certificate so signed that the excess consists wholly of persons not to be included in reckoning the number of fifty. Sec. 2 (1).

Conversion of Private Business into Companies

The object with which this private limited company system was introduced in company legislation originally, as we have already seen, was to enable private business being converted with a view to take the benefit of the limitation of liability, as well as to make it possible for persons willing to lend money to the concern to do so freely in the form of purchase of shares, particularly where they are prepared to incur certain risk though they do not wish to carry with them the burden of responsibility attached to the unlimited liability in case of heavy losses. The usual process here is for the firm which wishes to be converted into private limited company to agree to sell to the company which is being formed and the company agrees to buy the assets and the good-will of this business at a certain purchase price payable in shares fully or partly paid as may be mutually agreed which are to be divided among the partners. In order to avoid large stamp duty being paid on the contract or the conveyance, all assets are taken up by the new company and liabilities are paid by the company itself the usual practice is to arrange for the taking over of all stock in trade, free-hold and lease-hold properties and other items requisite for carrying over of the business. As to outstandings, they remain outstandings of the old firm and are to be collected by the new company as the agent for collection of debts on behalf of the firm who has sold its assets. The partners arrange to pay the liabilities themselves. If further capital is necessary, it is arranged to issue same among

partners in fixed proportion against payment of cash by them. In case of good-will also, if the same is sold for a fixed price and transferred by the firm to the company *ad valorem* stamp duty will have to be paid. Frequently to avoid this no arrangement is made for the sale of good-will, but the partners have to give a written undertaking to the company individually not to trade in competition with the new company. In fact it is usual, whether the good-will is sold or not sold to the company, to incorporate a clause in the agreement for sale by which the partners of the old firm agree not to compete with the company in course of its trade or allow this name to be used in any rival business. A form of agreement is given in Vol. II Appendix No. A.

With reference to the business of a deceased person, if the deceased has not given the power in his will to the executor to convert same into a private limited company it cannot be done and the Courts nowadays hold that there is no jurisdiction to do so though they did it in older cases. The only case where such a thing can be done in the absence of authority from the deceased is where such an arrangement is a part of a compromise of disputes with third parties (*Re. Morrison,* (1901) 1 *Ch.* 701; *Re. Crawshay,* (1889) 60 *L. T.* 359; *West of England Bank* v. *Murch,* (1883) 23 *Ch. D.* 138). The principle here involved being that the Court has jurisdiction only in case of emergency not foreseen or provided for by the author of the trust to allow a trustee to go outside the terms of the trust (*Re. New's Settlement,* (1901) 2 *Ch.* 534). It should be however noted that the sale by an insolvent of a substantial part of his assets is a fraudulent act under the Presidency Town Insolvency Act of 1909. Thus in case an insolvent sells substantial part of his property to a company, the sale can be set aside by the official assignee if the party is made an insolvent within three months (*Re. Hirth,* (1899) 1 *Q. B.* 612; *Re. Wheatley,* (1901) 85 *L. T.* 491). In this case (*Re. Hirth*) *Lindley, L.J.,* referred to the case of *Salomon* v.

Salomon & Co., (1897) *A. C.* 22, in which it was laid down that if in a joint stock company six persons held only one share each and the seventh held twenty thousand, the Court would not go behind the incorporation certificate and inquire whether such a "one man company" was one intended by the Act, said that "it has been decided that a company can be legitimately formed under the Companies Acts by one person or one or two persons, with all the rest men of straw, and that there is at present no machinery except winding-up by which it can be extinguished . . . . But the question was never raised there whether the creditors of a sole trader who had converted himself into a company and transferred all his assets to the company, could not impeach the transaction either as a fraud upon the creditors........or as an act of bankruptcy." The result was that it was laid down here that the transfer of this character of the assets was a fraud on the insolvent vendor's creditors and therefore an act of bankruptcy. The Court in such cases treats the parties who get the assets as trespassers. In one case the debenture holders under these circumstances were declared as such and compelled to hand back the assets in their possession and held liable to make good the value of the property they had disposed off (*Re. Goldberg,* (No. 2), *Ex-parte Page,* (1912) 1 *K. B.* 606).

In another case in *Re. Goldberg, Ex-parte Silverstone,* (1912) 1 *K. B.* 384, where an insolvent trader formed a private company and assigned all his assets to it for shares and debentures and also induced his mortgagee to accept debenture in lieu of his mortgage it was held that the mortgagee lost his mortgage (see also *Re. Slobodinsky, Ex-parte Moore,* (1903) 2 *K. B.* 517).

The Conversion of a Private Company into a Public Company

It is quite open to a private company to convert itself into a public company if it so desired because Section 154 which replaces the old section under the

Indian Companies (Amendment) Act of 1936 provides that :—

(1) *If a company, being a private company, alters its articles in such manner that they no longer include the provisions which, under the provisions of clause (13) of sub-section (1), of section 2, are required to be included in the articles of a company in order to constitute it a private company, the company shall, as on the date of the alteration, ceased to be a private company and shall, within a period of fourteen days after the said date, file with the registrar a prospectus or a statement in lieu of prospectus in the form and containing the particulars set out in the form marked II in the Second Schedule.*

(2) *If default is made in complying with sub-section (1) of this section, the company and every officer of the company who is knowingly and wilfully in default shall be liable to a fine not exceeding five hundred rupees.*

(3) *Where the articles of a company include the provisions aforesaid but default is made in complying with any of those provisions, the company shall cease to be entitled to the privileges and exemptions conferred on private companies under the provisions contained in this Act; and thereupon the provisions of this Act shall apply to the company as if it were not a private company.*

Provided that the Court, on being satisfied that the failure to comply with the conditions was accidental or due to inadvertence or to some other sufficient cause, or that on other grounds it is just and equitable to grant relief, may, on the application of the company or any other person interested and on such terms and conditions as seem to the Court just and expedient, order that the company be relieved from such consequence as aforesaid.

In connection with this it should be noted that the conversion involves the necessity of the directors having to file a consent to act in writing and consent to take and pay for the qualification shares (from which they were exempt in the case of the private company) unless they had already signed the memorandum of association for these shares at the time the company was incorporated.

In case a private company is prohibited by its articles

from converting itself into a public company, it is still open to it to alter its articles by a special resolution and convert thereafter.

As a matter of fact if a private company alters its articles in a manner that they no longer embrace the clauses which the Act requires to be there, it ceases to be a private company and thereby it automatically becomes a public company.

It will be noticed that the present Section 154 (2) provides that in case default is made in complying with sub-section (1) the company and every officer of the company who is knowingly and wilfully in default shall be liable to a fine not exceeding five hundred rupees.

It further enacts in S. 154 (3) that where the articles include restrictive provisions but these provisions are not acted upon or departed from and default is made, the company ceases to enjoy the privileges and exemptions of a private company, unless the Court is satisfied that the default was to accidental conditions or to inadvertence or any other sufficient cause.

The Procedure

The procedure is to first pass a special resolution converting the company into a public company and deleting the articles which restrict the transfer of shares, limit the membership to fifty and prohibit the offer of shares to the public. A copy of the special resolution or resolutions giving effect to these has to be filed with the registrar of joint stock companies within fifteen days of their passing. The next step is to file a statement in lieu of prospectus according to Sec. 98. The consent to act as directors and a consent to take up the qualification shares, if any, must also be filed unless they signed the memorandum of association at the time of incorporation. (S. 84). Finally file a declaration as required by Sec. 103 before commencement of business in accordance with Form 5 under the Indian Companies Rules, 1914, as given in the Vol. II, Appendix No. A.

RESOLUTIONS

Private Company Converted into Public

We have already seen that as soon as the restrictions required to be embodied in the articles are removed a private company automatically becomes public. The resolution passed is generally as follows :—

RESOLVED :—(*a*) That the company do convert itself into a public limited company and that the articles numbered...... ....be and are hereby deleted from the articles of association of the company.

(*b*) That the following new articles be and are hereby added to the company's articles of association and numbered....................

(Here set out the Articles.)

Public Company Converted into a Private Company

The resolutions to be passed when a public company is converted into private, the following form may be followed :—

RESOLVED :—That the company do now become a private company. That the articles numbered...............be and are hereby deleted and that the following new articles numbered......................be added to the articles of the company and form part of same :—

(Here set out the new Articles)

Application of Table " A "

The various sections of the Indian Companies Act, 1913, except those bearing on the points we have dealt with above, equally apply to private as well as public companies. A private company cannot adopt Table " A " as its articles of association without making considerable alterations and the general practice is to draw out a special set of articles in each case. This is because (1) the restrictions on the transfer of shares have to be provided for, (2) provision has also to be made with a view to limit the number of its members to fifty, (3) the requirements as to the directors' qualification, minimum

subscription, etc., are not necessary to be provided for, and (4) provisions 34, 35, 36, 37, 38, 39 and 40 of the Table "A" with regard to "share warrants" have to be eliminated.

Forms of Articles Peculiar to a Private Company

We have seen that in case of all private companies it is compulsory under the Act to restrict the number of its membership and also restrict the transfer of shares. In this case the following articles are usual :—

The company is a private company within the meaning of Section 2, sub-section (13) of the Act, and accordingly :—

(1) The number of members for the time being of the company (*not including persons who are in the employment of the company*) is not to exceed fifty provided that where two or more persons hold one or more shares jointly they shall be considered as a single member;
(2) No invitation shall be issued to the public to subscribe for any shares, debentures or debenture stock of the company;
(3) The right to transfer the shares of the company is restricted in manner and to the extent hereinafter appearing;
(4) No transfer of any shares of the company shall be registered, the registration of which would involve a contravention of clause (a) of this Article;
(5) The company shall not be at liberty to issue share warrants to bearer; and
(6) The company shall continue to observe such restrictions, limitations and prohibitions.

The Usual Articles Restricting the Transfer or Transmission of Shares in Private Companies

We have seen that it is absolutely necessary to place restrictions on the right to transfer shares in case of private companies and for apparent reasons a private company's articles cannot authorise it to issue share warrants. In what form the restrictions should be imposed is a matter to be decided by the promoters in consultation with their lawyers. A general reservation to the effect that directors in their absolute discretion may

refuse to transfer any share or shares would answer the requirement of law, but in practice care has to be taken to see that the refusal is not mendacious or capricious and is one which would ensure equity and fair play to the holders. We shall deal with the law on this subject while dealing with transfer. The following set is the one usually to be found in the articles of association of private companies and it is most satisfactory inasmuch as a fair price is defined in the second clause and thereafter an option is left to the transferor, if not satisfied, to get the valuation done by arbitration. In some cases this third clause about arbitration is omitted and a fair price as fixed by members in a general meeting or one fixed by the auditors of the company as certified by them is provided for to be the fair price. It is also usual to provide that the restrictive clauses are not applicable to certain individual members, wholly or partly, who are named in the articles. The fair value in many cases is fixed by articles as the paid-up amount on the shares. For articles empowering the company to compel a member to sell his shares etc., see expropriation of members in Index.

Frequently clauses are so framed that a transferor is compelled to fix a price himself and if the price is not acceptable to the directors or members to whom the shares are to be offered in the first instance, they can be sold by him at that price to an outsider but not at any lower price. In one case where a member intending to sell had to fix his price and offer shares at that price to his fellow members through the board of directors and did so offering 1,35,000 shares of £1 each at £2 each, but the directors could arrange to buy under the option 5,000 shares only, it was held that the transferor was not bound to sell a part of his holding, as the offer and the price fixed was in respect of the whole of 1,35,000 shares and not for each share of the holding separately, for which he would be entitled to ask for a different price (*The Ocean Coal Co., Ltd.* v. *The Powell Duffryn S. Coal Co.,* (1932) 1 *Ch. D.* 654; 48 *T. L. R.* 290). In another case with the

usual article to give notice and offer shares to members in first instance, a private sale was made to a member without notice which was declared good (*Delavenne* v. *Broadhurst*, (1930) *W. N.* 238).

Model Articles Providing for Sale or Transfer to a Member only

Transfer when member willing to purchase.

(1) No shares shall be transferred to a person who is not a member so long as any member is willing to purchase the same at the fair value which shall be determined as hereinafter provided.

Notice to be given by transferor.

(2) In order to ascertain whether any member is willing to purchase the share, the proposing transferor shall give notice in writing (hereinafter called the "Transfer Notice") to the company that he desires to transfer the shares. Such notice shall constitute the company, his agent for the sale of the share to any member of the company at the fair value. The transfer notice may include several shares and in such case shall operate as if it were a separate notice in respect of each. The transfer notice shall not be revokable except with the sanction of the directors.

Value when fixed by the company.

At the Ordinary General Meeting in each year the company shall by ordinary resolution declare what is the fair value of a share, and upon any sale pursuant to this article the amount so declared with the addition thereto of 6 per cent. per annum from the date of the meeting to the date of the completion of such sale (less any dividend declared in the meantime) shall be deemed to be the fair value for the purpose of such sale.

Value when to be fixed by auditor, etc.

(3) If the proposing transferor shall be dissatisfied with the price so fixed by the company or if from any cause no resolution fixing the fair value shall have been passed by the company within the year last preceding the date of the transfer notice, the fair values shall be such sum as shall be fixed by the auditors of the company on the one hand,

and the public accountant nominated by the proposing transferor on the other hand within seven days after notice requiring him to nominate a valuer to act on his behalf shall have been given to him by the company or in the event of the disagreeing, such sum as shall be fixed on the valuation. The cost of such valuation shall be paid at the same amount as that fixed by the company or at a less amount and in any other case such cost shall be paid by the company.

NOTE :—In case an auditor is given the sole power to decide, the article would, according to precedents take the following form :—

"In case any difference arises between the proposing transferor and the purchasing member as to the fair value of a share, the auditor shall, on the application of either party, certify in writing the sum which, in his opinion, is the fair value, and such sum shall be deemed to be the fair value, and in so certifying the auditor shall be considered to be acting as an expert, and not as an arbitrator; and accordingly the Arbitration Act, 1889, shall not apply."

When it is proposed to give both the parties a chance of appointing arbitrators in order to decide the fair value of the share according to precedents, the article would take more or less the following form :—

"In case any difference arises between the proposing transferor and the purchasing member as to the fair value of a share, the difference shall be referred to two arbitrators, one to be appointed by each of the parties in difference."

In case where it is proposed not to leave the computation of fair value to any arbitrator but to provide for same in the article itself the following form according to precedents

with such alterations as may be desired may be followed :—

"For the purposes of these clauses the fair value of a share shall be the amount for the time being paid-up thereon plus a premium (if any), regulated as follows :—*i.e.*, if the dividend and bonus for the financial year immediately preceding shall not exceed 7½ per cent. per annum, the shares shall be offered at the amount for the time being paid-up thereon; if such dividend and bonus shall exceed 7½ per cent. per annum, but not exceed 10 per cent. per annum, the premium shall be 10 per cent. on the amount paid-up, and if such dividend and bonus shall exceed 10 per cent. per annum, but not exceed 15 per cent. per annum, a premium of 20 per cent. on the amount paid-up, and if such dividend and bonus shall exceed 15 per cent. per annum &c., &c."

Procedure when company finds purchaser.

(4) If the company shall within the space of the 28 days after being served with the transfer notice to find a member willing to purchase the share (hereinafter called the "Purchasing Member") and shall give notice thereof to the proposing transferor, he shall be bound upon the payment of the fair value to transfer the share to the purchasing member.

Default by transferor to transferee.

(5) If in any case, the proposing transferor, after having become bound as aforesaid, makes default in transfering his shares, the company may receive the purchase money and thereupon cause the name of the purchasing member to be entered in the register as the holder of the share, and shall hold the purchase money in trust for the proposing transferor. The receipt of the company shall be a good discharge for the purchasing member and after his name has been entered in the register in purported

exercise of the above power, the validity of the proceedings shall not be questioned by any person.

Default by company to find purchaser.

(6) If the company shall not, within the space of 28 days after being served with the transfer notice, find a member willing to purchase a share or any of them and shall not give notice in the manner aforesaid, the proposing transferor shall, at any time within three calendar months afterwards, be at liberty to sell and transfer the shares (or those not placed), to any person at any price.

Company may make rules as to sale of shares, etc.

(7) The company in general meeting may make and, from time to time, vary rules as to the mode in which any share specified in any notice shall be offered to the members, and as to the right in regard to the purchase thereof and in particular may give any member or class of members a preferential right to purchase the same. Until otherwise determined, every such share shall be offered to the members in such manner as is herein provided with regard to the allotment of shares issued by the company or as near thereto as may be.

Transfer of shares to members' family.

(8) Any share may be transferred by a member to any son or grandson, daughter or granddaughter, nephew or niece, or wife or husband of such member and any share of a deceased member may be transferred by his executors or administrators to any son or grandson, daughter or granddaughter, nephew or niece, widow or widower of the deceased member, and shares standing in the name of the trustee of the will of any deceased member may be transferred upon any change of trust to the trustees for the time being of such will.

In connection with the above it may be noted that it has been held that if the restriction is general and not limited to a certain number or section of shares there is no objection to it. Thus a restrictive article such as the above which tend to compel a member to transfer his shares to a particular person and at a particular price is not either repugnant to absolute ownership or tending to

perpetuity and is therefore valid (*Borland's Trustee* v. *Steel Brothers & Co.*, (1901) 1 *Ch.* 279). In this case the articles provided that such ordinary shareholders who were not engaged in management should transfer their shares to those engaged at a fair value arrived at as provided for in the articles. These provisions were objected to on the grounds that the articles were repugnant to the idea of the nature of personal property and were also violating the rule against perpetuity. *Farewell, J.*, held that this was an attempt to apply to company law a principle altogether foreign to it.

We have already considered articles providing for the compulsory retirement of competing members in connection with the model articles when discussing the expropriation of members. There are similar articles made applicable to dismissed servants holding shares.

PREFERENTIAL RIGHT OF PURCHASE TO DIRECTORS AND OTHER MEMBERS

In case of private companies one frequently finds articles providing that in case the company issues fresh shares they would be offered in preference to either the directors or the present members or to some specific member or to larger holders. This is because virtually speaking in most of these private limited companies the directors are the holders of the largest number of shares and in possession of the management of the whole concern, particularly where a partnership has converted itself into a private limited company. The precedents of these articles are in more or less the following form which may be adopted with such alterations as may be necessary :—

Preference to directors.

"All shares comprised in a transfer notice shall, unless the directors think fit to offer them to any person selected as aforesaid, be first offered by the company to the directors themselves, and so that in case of any difference between them as to the disposal or

distribution of a share or shares, the mode of disposal or distribution shall be determined by lot, and any shares not taken by the directors, or some or one of them, shall then be offered to the other members in such order as shall be determined by lot. And in each case the person to whom the offer is made (whether a director or not) shall have the option of buying at the price fixed in the transfer notice, or, at his option, at the fair value, to be fixed by the auditors, as aforesaid, such option to be declared in accepting the offer. Where the shares comprised in a transfer notice stand in the name of a deceased member, the directors shall have three calendar months from the service of the transfer notice within which to determine whether they will themselves purchase them or not."

Preference to a particular member of the company.

"Until otherwise determined, every such share shall be offered in the first place to the said A, and any not accepted by him shall then be offered to the said B, and any not accepted by him shall be offered to the other members in such order as shall be determined by lots drawn in regard thereto under the supervision of the governing directors."

Preference to large holders.

"Until otherwise determined by extraordinary resolution of the company, the shares comprised in any transfer notice shall be offered in the first place to the principal shareholders (which expression in this clause means and includes those members who respectively hold at least 10 per cent. of the issued capital), and such offer shall be made to them collectively and individually, but so that in case of competition they shall rank for acceptance *pari passu* in proportion to the shares held by them, and so that if any shares cannot be so apportioned, such shares shall be offered to them in order determined by lot, and the directors shall cause lots to be drawn accordingly, and any shares not taken up by the principal shareholders as aforesaid shall be offered to the other members in such order as shall, &c."

Preference to highest bidders.

"Where the company is served with a transfer notice as aforesaid, the company shall forthwith give notice thereof to all the members (other than the party giving the transfer notice), and the notice shall specify the price fixed by the intending transferor, and each member shall be at liberty, within fourteen days from the time such notice is served on him, to deliver to the company an offer in writing bidding for all or some of the shares comprised in the transfer notice, and agreeing to take, at the price he bids, the whole or any of the shares he bids for; and as between those who so bid the highest bidders shall be selected as purchasers in the order in which their bids stand as regard magnitude; and as between those who bid the same figure the selection shall be determined by lots, which shall be drawn in such manner as the directors determine. Nevertheless, if the selected bidders include any who bid less than the price specified in the transfer notice, the company shall call on the auditor to certify what sum is, in his opinion, the fair value per share, and shall notify the same to such last mentioned bidders, and unless they forthwith bid such price, their bids shall be disregarded."

Precedent of Article for Compulsory Purchase of Shares of Dismissed Servant

In case of any member of the company who is also an employee of the company being dismissed from such service or employ for misconduct, the directors may at their discretion within one month of the date of such dismissal resolve that such member do retire and thereupon such member shall be deemed to have served upon the company a transfer notice pursuant to clause............hereof and to have specified therein the amount paid-up on each share to be the fair value of each such share.

Precedent of Article Where Shares are Compulsorily Acquired or Forfeited for Competing

In case any member of this company becomes a manager or director or partner of any concern which is carrying on business

of a competing nature without obtaining the consent of this company by an extraordinary resolution (by the resolution of the board of directors) he may be served with a notice by the board of directors requiring him to retire from the competing concern or terminate his interest in same in any manner approved by the board and in the event of non-compliance with such requirement within thirty days or any extended period at the option of the board from the date of service of the aforesaid notice his shares are liable to be forfeited.

Instead of forfeiture the words may be; "he shall be deemed to have served the company with a notice pursuant to Cl..........of the articles hereof and to have agreed to transfer his shares to any member willing to purchase same at a fair value to be fixed by the auditors of the company for the time being (or by the company in the general meeting)."

Transmission of Shares

Representatives of deceased members only recognised.

(1) The executors or the administrators of a deceased member (whether a Parsi, European, Hindu, Mahomedan or otherwise) shall be the only persons recognised by the company as having any title to the shares registered in the name of such members except in cases of joint holders in which case the surviving holder or holders or the executor or the executors or administrators of the surviving holder, shall be the only persons entitled to be so recognised, but nothing herein contained shall release the estate of a deceased joint holder from liability in respect of any share jointly held by them. The company shall not be bound to recognise such executors or administrators unless they shall have obtained probate or letters of administration or other legal representation, as the case may be, from a duly constituted Court in British India, having effect in the city of Bombay. Provided nevertheless that in any case where the board in their absolute discretion thinks fit it shall be lawful for the directors to dispense with the production of probate or letters of administration, or such

other legal representation, upon such terms as to indemnity or otherwise as to the directors may seem meet.

Transfer of shares of deceased and insolvent members.

(2) Any person becoming entitled to shares in consequence of the death or insolvency of any member, or any way other than by transfer, upon producing such evidence that he sustains the character in respect of which he proposes to act under this article of this title, as the directors think sufficient, may, with the consent of the directors (which they shall not be under any obligation to give), and upon a fee of such an amount not exceeding one rupee per share as the directors may require being paid to the company for registration, be registered as a member in respect of such shares or may, subject to the regulations as to transfers hereinbefore contained, transfer such share.

Notice requiring consent by person claiming by transmission to be registered as a member.

(3) If any person mentioned in articles one or two of this presence shall not himself become registered as member, or shall not execute a transfer which shall be registered pursuant to those articles within three calendar months after his rights shall have first accrued, the director shall not be compelled to recognise the title of the person claiming under which transmission, and if such person entited to be the holder of any partly paid shares of the company, shall not have complied with the provisions aforesaid during and for the said period of three calendar months, the directors may cause notice to be served on him requiring him within a period of not less than one month from the date of such notice to comply with the said provisions, that if he does not comply with the requirements of the said notice, the shares, in respect of which such notice is given, will be liable to forfeiture, and if the person on whom such notice has been served shall not comply with the requirements thereof within the time named therein, the shares, in respect of which the

> notice was given, shall be liable to be forfeited by a resolution of the directors passed at any time before the requirements of the said notice shall have been complied with.

It may be added that the above articles may be varied a little here and there as the circumstances peculiar to the company concerned may warrant.

The object of these restrictions is to prevent, as far as possible, the number of members exceeding the limit laid down by the Act, of fifty (not including those in the employment of the company) and at the same time to give the first option of purchase to the existing members of the private company. Frequently it is provided that the price of the shares to be transferred may be fixed by the shareholder himself and in such case it is further provided that if the shares are not purchased by the existing members at the price so fixed by him he cannot sell to any outsider for a lesser price. Of course there is always the saving clause which gives absolute discretion to the directors to register any transfer without giving reasons. In the above articles it will be noticed that the value is to be fixed according to this clause by the ordinary general meeting in each year and there is a further provision that if the proposing transferor is dissatisfied with the price so fixed the auditor of the company and a public accountant nominated by the proposing transferor may fix same. It may be that this latter article may not be necessary and may be omitted in which case the transferor will have to rely upon the ordinary general meeting for valuation.

We have already seen that the articles in connection with the expropriation of a competing member, and the law applying to same is also applicable in case of private companies.

Managing Director

In case of a private limited company it is not at all compulsory to appoint directors though generally two

or more members are appointed board of directors. There are cases where the managing director or even an ordinary director is appointed for life and frequently his name is actually mentioned in the articles. The usual form of articles in connection with the managing director is as follows :—

Appointment and removal of managing director.

"The directors may from time to time appoint one or more of their body to the office of managing director or manager for such time and at such remuneration as they may think fit. The directors may from time to time confer upon and entrust to the managing director or manager all or any of the powers of the directors (except the power to make calls, forfeit shares, borrow money, or issue debentures) that they may think fit. But the exercise of all powers by the managing directors or manager shall be subject to such regulations and restrictions as the directors may from time to time impose, and the said powers may at any time be withdrawn, revoked or varied."

One other form of the appointment of managing director in case of private or public companies is as follows :—

Powers and duties of managing director.

"The directors may from time to time entrust to and confer upon a managing director for the time being such of the powers exercisable under these presents by the directors as they may think fit, and may confer such powers for such time, and to be exercised for such objects and purposes, and upon such terms and conditions, and with such restrictions as they think expedient; and they may confer such powers, either collaterally with, or to the exclusion of, and in substitution for all or any of the powers of the directors in that behalf; and may from time to time revoke, withdraw, alter or vary all or any such powers.

Where no managing directors are appointed the word manager will be substituted in place of the managing

director and he shall be mentioned in the articles as the manager to be appointed by the members. When the managing director is appointed by the articles as a life director the article runs as follows :—

Mr. X shall be the managing director for life or until such time as he resigns without any limitation as to the period he is to hold such office and shall receive such remuneration as shall be fixed by the company in the general meeting by way of salary or commission or participating any profit or by any or all of these modes.

It may be added that the other usual clause which should find a place in the articles of association for private companies is one which gives a lien to the company on the shares of a member for any amount that the said member may be owing to the company in the course of his dealings with company. This lien clause is dealt with in a subsequent chapter in connection with other articles, as will be found from the index. This lien clause is rather important because a private company generally has trade dealings with its own members who may have their own outside business besides holding large number of shares in the company itself as one of the principle members or proprietors. Besides the lien clause, the other important clauses are the forfeiture clauses in the articles giving power to forfeit shares which are also found in the articles of association of private companies. We have dealt with these clauses in one of the previous chapters.

Mr. Palmer in his book on Company Precedents gives a clause in which he gives what he calls the overriding powers of two-third majority in value of shares which according to him may be used in case of a company with a small number of members who are within personal reach of each other. It is as follows :—

Overriding powers of two-third majority in value of shareholders

Appointment of

"The holders for the time being of two-thirds of the issued shares may at any time, and from time to time, as and when they think fit, do all or any of the following things, that is to say :—

directors. Removal of directors. Remuneration of directors. Convene general meetings, regulate, conduct, of business, bills, notices, etc.

(1) They may, by notice in writing to the company, appoint any persons to be directors of the company.

(2) They may, by notice in writing to the company, remove any director of the company from office.

(3) They may, by notice in writing served on the company, fix the remuneration of the directors, or any particular director or directors.

(4) They may at any time convene a general meeting of the company.

(5) They may, by notice in writing to the company, make any regulations in regard to the conduct of the business of the company, or directors thereof, and in like manner may vary and annul any such regulations.

(6) They may, by notice in writing to the company, make any regulations declaring who shall be called to sign, on the company's behalf, cheques, bills, notes, acceptances and endorsements, and for what purposes and in what cases, and may in like manner annul and vary such regulations, and no signature to any such document shall be binding on the company unless it is in accordance with such regulations for the time being in force, and filed with the Registrar of companies.

(7) Whatsoever is done under this clause shall have full effect save that as regards any notice under paragraphs 5 and 6 of this clause it shall not have full effect until it is filed with the Registrar of companies.

(8) A notice in writing under this clause may be signed by the person giving the same, or any attorney or other agent of such person authorised in writing to give the same, or generally or specially."

Most of the other clauses of the articles in case of the private companies are same as those in case of public companies.

NOTE :—Instead of two-thirds of the issued shares any other proportion, say, half or three-quarters may be provided for in the above case.

CHAPTER VIII

Membership of a Company

SHARES AND INCIDENTS CONNECTED WITH THEM

Who can hold Shares ?

Any person who is *sui juris, i.e.,* not subject to any disability can be a member or shareholder of a company. A person of full age and sound mind who has the capacity to enter into contracts can become a shareholder. A married woman also can be a shareholder in connection with her separate property. In the case of an infant, as we shall see later, he can be a member, but may repudiate the shares during his minority and after attaining full age. (*Re. Laxon & Co., No.* 2, (1892) 3 *Ch.* 555).

The Definition of a Share

A share is defined by *Farwell, J.,* in (*Borland's Trustee* v. *Steel Brothers,* (1901) 1 *Ch.* 288), as " the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders *inter se*..........A contract contained in the articles of association is one of the original incidents of the share. A share is not a sum of money settled in the way suggested, but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount." " The word share does not denote rights only; it denotes obligations also (*Taylor Phillips Rickard's Case,* (1897) 1 *Ch.* 298)." Our Indian Companies Act, Sec. 2 (16) defines a share as follows :—" Share means share in the share capital of the company and includes stock except when

the distinction between stock and share is expressed or implied."

The Indian Companies Act, 1913 (S. 28) declares a share, or other interest of any member in a company, to be a movable property which is transferable in the manner provided for by the articles of association of the company and provides that each share in a company having a share-capital shall be distinguished by its appropriate number. This being personal estate it passes to the executors or administrators and not to heirs. When a will orders investment in "securities" they do not include shares. A more specific mention here is necessary (*Ogle* v. *Knipe,* (1869) 8 *Eq.* 434; *re. Johnson,* (1904) 89 *L. T.* 520). The Indian Sale of Goods Act of 1930, Sec. 2 (7) defines Goods as :—" Every kind of movable property other than actionable claims and money; and includes stock and shares, etc." It has however been held that share certificates passing from hand to hand with blank transfer deeds do not become negotiable instruments and thus a *bona fide* purchaser who is in possession of them by fraud does not acquire a good title (*Hazarimal* v. *Satish Chandra Ghose,* (1919) 46 *Cal.* 331). See also *Fazal D. Allana* v. *Mangaldas M. Pakvasa,* (1921) 23 *Bom. L. R.* 1144 where it has also been laid down that :—(1) Share certificates are "Goods" under Sec. 108 of the Indian Contract Act (now Sale of Goods Act, 1930). (2) If a contract to sell is obtained by fraud or cheating it can be set aside but if the performance of the contract is so obtained it cannot be avoided. Each share in a company which has a share-capital must be distinguished by its appropriate manner (Sec. 28).

The shares are acquired by persons who thus become members of a joint stock company in any one or more of the following ways :—

(1) By subscription to the memorandum of association.
(2) By application and allotment.
(3) By transfer.
(4) By transmission.

A SUBSCRIBER TO THE MEMORANDUM OF ASSOCIATION

Persons who subscribe to the memorandum of association of a company, become the first and the original shareholders, or members, because they state against their respective names (in case of a company whose capital is divided into shares), the exact number of shares they agree to take up. Here it is necessary that the signatory to the memorandum of association should be put on the register as he acquires the status of a member and is bound to take up and pay for the shares written opposite his name (*Tyddyn Sheffrey Slate Quarries Co.*, (1869) 20 *L. T.* 105). As a company has no existence prior to the signing and filing of the memorandum, a person who has signed a memorandum, cannot obtain rescession of his agreement to take shares on the ground of fraud (*Lurgan's Case,* (1902) 1 *Ch.* 707). The memorandum must be signed by the requisite minimum because when once the memorandum is registered and the registrar's certificate is obtained it is conclusive that the company is duly registered. We have seen the registrar must refuse to accept the memorandum at any time should he know that it has not been signed by persons of full age. The memorandum may be signed by an agent either in the name of his principal or in his own name as an attorney. The registrar, of course, in the latter case has a right to satisfy himself as to the agent's authority to sign and for that purpose a regular power of attorney properly stamped will have to be produced. Signatures have to be attested by at least one witness who should be a disinterested person. The subscriber to the memorandum may be relieved of his obligation to purchase shares he has stated before his name only if all the shares are allotted to others (*Evan's Case,* (1867) 2 *Ch.* 427). He has to purchase the shares himself which he has subscribed by transfer to him, or by allotment to him, of shares credited as fully paid to which a third party is entitled (*Migotti's Case,* (1867) 4 *Eq.* 238). A subscriber for preference shares, however, may take a like amount of

ordinary shares instead (*Duke's Case*, (1875) 1 *Ch. D.* 620).

In case of the subscribers of memorandum no allotment is necessary, neither any entry in the register of members need be passed (*Re. London and Provincial Consolidated Coal Co.*, (1877) 5 *Ch. D.* 525; *Nicol's Case*, 1885) 29 *Ch. D.* 421; *Alexander* v. *The Automatic Telephone Co.*, (1900) 2 *Ch.* 63). Here the subscriber is bound to take the shares and pay for them according to the calls that may be made from time to time, but he cannot get rid of his obligation by getting a transfer of fully-paid shares from another member, *i.e.*, he must purchase the shares himself from the company direct (*Re. Esparto Trading Co.*, (1879) 12 *Ch. D.* 191; *Evan's Case*, (1867) *L. R.* 2 *Ch. Ap.* 427). In one case the subscriber to the memorandum proved to the satisfaction of the Court that the shares he subscribed for were on behalf of his firm and he thus escaped personal liability as soon as they were allotted to the said firm (*Dunster's Case*, (1894) 3 *Ch.* 476). It is not open to a subscriber to a memorandum of association to repudiate his liability on the ground of misrepresentation or fraud (*Re. Metal Constituents Ltd.*, (1902) 1 *Ch. D.* 707). In the above case it was held according to the head-note that "assuming that the misrepresentation was made and acted on by the subscribers to the memorandum of association, nevertheless he was liable on the shares (1) because the company before it came into existence could not appoint an agent and was therefore not liable for the acts of the promoter and (2) that by signing the memorandum the subscriber on the registration of the company became bound not only as between himself and the company but also as between himself and the other persons who should become members."

APPLICATION AND ALLOTMENT OF SHARES

The usual practice is to issue the prospectus to the public by advertising it in the first instance in the newspapers as well as furnishing copies of the same to indivi-

duals applying for the same. A date is fixed up to which the applications are to be open. Usually an arrangement is made with the company's bankers to receive applications and the public are requested to send these applications, together with the application money, to these bankers. The bankers collect these applications, enter the application money in the proper order of dates in the pass-book allotted to the company, and sign and hand over a receipt for the money to the applicant, on the receipt form which is generally attached to the application forms ready to be filled in and detached. The application money must be at least five per cent. of the nominal value of the shares and must be paid to or received in cash by the company. The words "paid to or received in cash by the company" will only be satisfied, when the cheques received actually are cashed or honoured (*Mears* v. *Western Canada Pulp and Paper & Co.,* (1905) 2 *Ch.* 353; *National Motor Co.,* (1908) 2 *Ch.* 228; *Burton* v. *Bevan,* (1908) 2 *Ch.* 240). *All monies received from applicants for shares must be deposited and kept in a scheduled bank as defined in the Reserve Bank of India Act of 1934, until returned or until the certificate to commence business is obtained. Any default or contravention of this provision entails a fine not exceeding rupees five hundred on every promoter, director or other person knowingly responsible for same.* (Amendment Act, 1936). After the close of the last date of application the bankers forward the applications, together with the pass-book, to the company's office. If the minimum subscription, as fixed by the memorandum, or the articles, and named in the prospectus, or where no such minimum is fixed, the whole amount of the share-capital offered for subscription, has not been subscribed for within one hundred and *eighty* days after the issue of the prospectus, all money received from the applicants must be immediately repaid. Failing such repayment within further ten days the directors of the company make themselves jointly and severally liable to repay the same with interest at the rate of seven per cent. annum from the

expiry of the one hundred and *ninetieth* day after the first issue of the prospectus (S. 101, Comp. Act 1913). Allotments made in defiance of this rule shall be voidable at the instance of the applicant within one month after the holding of the statutory meeting even though the company may be in course of liquidation by that time.

We shall however assume that the minimum subscription has been applied for. The applications are then to be considered by the directors at their board meeting to be held for that purpose. It may be added that the articles usually give the directors the power to reject any application, or transfer without giving any reason. The directors are thus in a position to select from the applications before them, members of their choice. There are also occasions when the number of applications for shares are in excess of the actual amount offered to the public. Here also discretion is to be used as to whom the " letters of allotment " and to whom the " letters of regret " should be sent. In case of large companies the most convenient course is to delegate this work to a small committee consisting of the chairman and a couple of directors whose recommendation or selection is formally approved at the next board meeting.

FORM OF APPLICATION LETTER.

The form of application duly filled in will be as follows :—

To

The Bombay Spinning & Weaving Co., Ltd.

Gentlemen,

Having paid to the company's bankers, the National Bank of India, Ltd., the sum of Rs. 100 being a deposit of Rs. 10 per share on ten shares in the above-named company, I request you to allot me that number of shares upon the terms of the company's prospectus dated the 21st day of August, 1937 and I hereby agree to accept the same, or any smaller number that may be allotted to me and to pay the balance of Rs. 99 per share as provided by the said prospectus, and I authorise you to register me as the holder of the said shares.

Name in full......Jivanji Pragji.
Address............15, Churchgate Street.
Description........Merchant.

Date..............25th August, 1936.
Signature...........Jivanji Pragji.

A receipt form is generally annexed to the application form as shown above and as soon as the applicant pays the money either at the company's office, or at the office of the company's bankers, the bankers fill in that receipt form, sign it and return the same to the applicant. The receipt is in the following form :—

THE BOMBAY SPINNING & WEAVING COMPANY, LIMITED.

Banker's Receipt to be retained by the Applicant.

Received this 25th day of August, 1937 of Mr. Jivanji Pragji the sum of Rs. 100 being a deposit of Rs. 10 per share upon 10 shares in the above-named company.

For the National Bank of India, Ltd.,

(Sd.) M. McDonald,

Cashier.

Stamp

FORM OF ALLOTMENT LETTER.

The directors' board meeting would then be held at a fixed date to consider the applications received, at which meeting the directors would decide whether they are to allot all the shares applied for or in case where a larger number are applied for than available, the directors would decide as to whom the letters of allotment or the letters of regret should be sent. Assuming that the above applicant has been allotted the shares he applied for, the letter of allotment would be in the following form :—

THE BOMBAY SPINNING & WEAVING COMPANY, LIMITED.

Bombay, 27th August, 1937.

To

Mr. Jivanji Pragji,

Dear Sir,

I am directed to inform you that in accordance with your application, the directors have allotted to you 10 shares of Rs. 100 each in the above company.

The sum of Rs. 20 per share is payable thereon upto and on allotment making the sum of Rs. 300 in respect of which you have paid on application Rs. 100 leaving a balance of Rs. 200 payable by you, which I am instructed to request you to pay to the bankers of the company, the National Bank of India, Ltd.

It will be necessary for you to produce this letter of allotment at the time of payment.

Yours faithfully,
(Sd.) J. Fernandez,
Secretary, pro tem.

We have seen above that usually the applications are made out in writing, but an oral application is as valid as one in writing. The applications are so many offers from persons sending them, desiring to take up the shares indicated therein and agreeing in case of allotment to pay for same as per the regulations of the company. The allotment constitutes an acceptance of this offer (*Motilal* v. *Thakorlal,* (1912) 14 *Bom. L. R.* 648). The usual law, therefore, as to offer and acceptance according to the provisions of the Contract Act will apply. From this it will be noticed that, unless the application form is so drafted as to admit of a smaller number being allotted, the agreement will not be complete. In actual practice there is always a reservation in the application form to that effect, by which, the applicant agrees to take up and pay for the shares applied for " or any smaller number that may be allotted." It also follows from this that, after the application is sent up, and before the shares are actually allotted, a shareholder can, if he so desires, withdraw his application (*Pentelow's Case,* (1869) 4 *Ch.* 178; *Wilson's Case,* (1869) 20 *L. T.* 962). Here, the revocation, according to the usual rules of the Contract Act, must reach the company before allotment. In this connection it has been held further that this revocation can be oral, and that, " In the absence of evidence to the contrary, the Court will infer that a clerk in the registered office of a company is, during business hours, and while the secretary is absent, so far in charge of the office, that he has authority to receive a notice so as to make it a com-

munication to the company" (*Truman's Case*, (1894) 3 *Ch.* 272). Thus an oral revocation communicated through the clerk may be sufficient. We have already seen that, the company cannot proceed to allotment unless the minimum subscription provided in the prospectus is applied for. The usual method by which the shares are allotted is the sending out of formal allotment letters signed by the secretary or managing agents of the company. It has been held in *Bellary Electric S. Co., Ltd.* v. *Kanniram Rowoothmal,* (1933) 56 *Mad.* 391 that application being an offer to purchase shares, it must not only be accepted but the acceptance must be communicated to the person making the offer. Thus a shareholder to whom the acceptance is not communicated is not bound by the contract and a mere entry of his name in the company's register is not sufficient for this purpose. In this case, the allotment will be complete at the moment of time the letter is posted. In this connection it may be added that, the allotment should be made by the directors in such a way as would result in the best interests of the company. In (*Percival* v. *Wright,* (1902) 2 *Ch.* 421), *Swinfen Eady, J.,* in the course of his judgment said, that "Directors must dispose of their company's shares on the best terms obtainable, and must not allot them to themselves, or their friends, at a lower price in order to obtain a personal benefit. They must act *bona fide* for the interests of the company." From this arises the question, whether, the directors can allot the shares at par when they are quoted on market at a premium. To that the answer is that, where they offer these shares to all the shareholders and give all of them the benefit of premium impartially, there can be no objection. But they should not allot shares quoted at a premium, to themselves, or their friends, at par. We have seen that the allotment letters are usually sent out by post. In this connection it must be noted that the letters should be actually posted and that, sending same through a postman will not be considered as posted, unless the postman is specially autho-

rised to take such letters. This point was laid down in *Re. London and Northern Bank, Ex-parte Jones,* (1900) 1 *Ch.* 220. Where according to the head-note "Jones applied for shares in a company, but before the letter of allotment was posted—except by being delivered to a postman in London street to be posted by him—the letter withdrawing his application was delivered at the company's registered office and opened by the Secretary. (By the rules of the post office, postmen are forbidden to take charge of letters for the post) *held,* that the withdrawal was received by the company before the allotment letter was posted and that there was no contract by Jones to take the share." Though a mere allotment is not a contract unless communicated, there may be an executory contract for allotment prior to allotment (*Bai Mangu* v. *Bharatkhand Cotton Mills Co.,* (1930) 32 *Bom. L. R.* 812). In case allotment is disputed for want of notice, the onus of proof lies on the company that notice of allotment was given (*Reidpath's Case,* (1870) *L. R.* 11 *Eq.* 86). This onus may be discharged by the company that the allottee had acted in a way which went to show that the member was aware of the allotment and had assented to it (*Crawley's Case,* (1869) 1 *Ch. App.* 322; *Re. Richards and Home Assurance Association,* (1871) *L. R.* 6 *C. P.* 591).

If the company sends an allotment to a party who has not applied for shares that allotment will be only an offer and will not come into force unless the person who has not applied accepts that offer; in order to form a valid allotment the same of course should be made by a duly-constituted board (*In re. Homer District Consolidated Gold Mines; in re. Smith Ex-parte,* (1888) 39 *Ch. D.* 546). The irregularly-constituted board's allotment may be ratified by that of a regular board later on (*Portuguese Consolidated Copper Mines; in re. Steele's Case,* (1889) 42 *Ch. D.* 160). In one case where a director who had joined in the allotment of certain shares to himself was prohibited or stopped from urging the invalidity of the allotment (*York Tramways Co.* v. *Willows*

(1882) 8 *Q. B. D.* 685). In one case where a company did not give a notice of allotment but only sent a letter demanding payment of the allotment money it was held that this was sufficient acceptance of the application for shares (*Forget* v. *Cement Products Co. of Canada,* (1916) *W. N.* 259). Of course the notice of allotment is not necessary in order to complete a contract in certain cases where it appears that an applicant has already waived such notice which may happen where some agreement has been made to take up shares on reconstruction or amalgamation (*In Re. Gunn's Case; in re. Universal Banking Corporation,* (1867) *L. R.* 3 *Ch. App.* 40). A letter of allotment has to be stamped with a two annas adhesive postage revenue stamp. In one case, *viz.,* (*Vollans* v. *Fletcher,* (1847) 1 Exch. 20) where the letter of allotment was not *ad idem* with the application for shares and therefore was not a contract, it was held not liable to duty. It has been further held that an allotment of shares is merely a contract until it is completed by a registration (*Re. Florence Land Co.; in re. Nicol's Case,* (1885) 29 *Ch. D.* 421). The complete status of a member of a company is only achieved after a shareholder is placed on the register except those who, as we have seen before, signed the memorandum and articles of association, in whose case they acquire the status of members irrespective of the fact whether they have been placed on the register or not. Once a member has acquired the status of a member by being duly entered on the register and fulfilling all legal obligations and if he has been removed wrongfully from there, say through forged transfer, that will not alter his status and he will still remain a member (*Barton* v. *L. N. W. Rail Co.,* (1889) 24 *Q. B. D.* 77). The entering on the register must be unconditional and if any stipulation is entered together with the name of the member it has been held that he has not acquired a complete status of a member (*Spitzel* v. *Chinese Corporation,* (1899) 80 *L. T.* 347). Of course if a person is entered on the register of members without a contract, or through

fraud, he cannot be saddled with the responsibilities of a member (*Humphrey & Denham* v. *Kavanagh,* (1925) 41 *T. L. R.* 378). An allotment made after an unreasonable delay may be repudiated by the applicant, because the same must be accepted under the ordinary rules of offer and acceptance within a reasonable time (*Crawley's Case,* (1869) *L. R.* 4 *Ch. App.* 322). What is a reasonable time, of course as usual, depends upon the circumstances of each case, but of course the right of repudiation must be exercised by the allottee without losing time.

Again it has been laid down in *Motilal Chunilal* v. *Thakorlal Chimanlal,* (1912) 14 *Bom. L. R.* 648 that where an application for shares is subject to a condition precedent, that condition must be performed to create a liability to take them. Where the application is subject to a condition subsequent, the liability arises, although the condition is never complied with. In this case the defendant was induced by the agent of the company to take up ten shares and when the former expressed his doubt as to whether the business would be profitable, he was told "Don't pay for the shares unless a dividend is paid." Thereupon the defendant signed the contract and the shares were allotted to him and he was entered on the register as a member. Here in liquidation, the defendant was forced to contribute the unpaid call money as the condition was only a condition subsequent.

Another Bombay case in which they held on the footing that the condition to be fulfilled was condition "precedent" is *Ramanbhai* v. *Ghashiram,* (1918) 20 *Bom. L. R.* 692. Here the applicant for 400 shares on condition that he was to be appointed a cashier and the Court held that the applicant had no intention to become a member of the company until he had been appointed a cashier and was therefore not bound to take up and pay on the shares as the condition was not fulfilled.

There are English cases also on the above point of conditional applications and there the principle laid down

is that where there is a conditional application, say to the effect that "if you appoint me your chief accountant I will take up 500 shares for which I hereby send you a formal application" or something to the effect that there is no contract because the parties are said to be not *ad idem* (*Rogers' Case; Harrison's Case; in re. Universal Banking Co.*, (1868) *L. R.* 3 *Ch. App.* 633; *in re. Wood's Case; Sunken Vessel Recovery Co.*, (1858) 3 *De. G. & J.* 85; *in re. Shaw's Case; New Buxton Lime Co.*, (1876) 34 *L. T.* 715). Of course in such a case too when such an allotment is made, the allottee must repudiate immediately, otherwise he will be taken to have waived the condition and be bound by the allotment (*In re. Wheatcroft's Case; Matlock Old Bath H. Co.*, (1873) 29 *L. T.* 324).

With reference to condition subsequent or a contract co-lateral to the application, the applicant on allotment becomes a shareholder and is bound by his agreement to take up shares and pay for them but the right he gets is to enforce the agreement or the condition subsequent later on (*Fisher's Case & Sherrington's Case,* (1885) 31 *Ch. D.* 120; *Elkington's Case,* (1867) *L. R.* 2 *Ch. App.* 511).

The Court may in its discretion in case of an agreement to take up shares or to allot shares decree specific performances but the party who wants to apply for this remedy must come without losing time or without delay (*New Brunswick & C. R. & L. Co.* v. *Muggeridge,* (1860) 1 *Dr. & Sm.* 363; *Odessa Tramways Co.* v. *Mendel,* (1878) 8 *Ch. D.* 235; *in re. Nicol's Case,* (1885) 29 *Ch. D.* 421).

In *Bansidhar* v. *Tata Power Co., Ltd.* (1925) 27 *Bom. L. R.* 330, which we have already considered when the applicants for shares were held to have applied for the shares on a misreading of the prospectus and not on the faith of any representation and therefore they could not escape liability to pay for the shares.

A person may not only apply for shares for himself but he may also apply on behalf of others and in the name of others if he has the necessary authority (*Duff's Executors' Case,* (1886) 32 *Ch. D.* 301). In this case of

course the secretary or the director should see whether the authority includes power to apply for shares. As soon as the agent duly authorised applies for shares on behalf of his principal and the shares are allotted, the principal becomes bound by the allotment (*Barrett's Case*, (1864) 4 *De. G. J. & S.* 416; *Hannan's Empress Gold Mining & Development Co.; in re. Carmichael's Case*, (1896) 2 *Ch.* 643). Thus if a duly authorised agent is also given certain private instructions by his principal limiting the authority of the agent and if the agent applies and conceals the private instructions violating them, the principal will still be bound (*In re. Henry Bentley & Co., or Bentley (Henry) & Co.*, (1893) 69 *L. T.* 204). Where a person applies for shares in a fictitious name and the shares are so allotted, the company has a right in holding him responsible by substituting his real name on the register (*Pugh & Sharman's Case; in re. Hercules Insurance Co.*, (1872) *L. R.* 13 *Eq.* 566). In the same case it was held that if an application was sent in the name of an infant or any other person who is not *sui juris*, it would be treated as an application in a fictitious name (see also *Richardson's Case; in re. Imperial Mercantile Credit Association*, (1875) *L. R.* 19 *Eq.* 588). A public company cannot allot unless it has either filed a prospectus or statement in lieu of prospectus and then too after the minimum subscription has been applied for (Secs. 98 and 101). The allotment is not void in case the statement in lieu of prospectus has been filed but is defective (*Blair Open-Hearth Furnace Co.*, (1914) 1 *Ch.* 390; *Jubilee Cotton Mills*, (1923) 1 *Ch.* 1; (1924) *A. C.* 958). This rule has to be strictly complied with, because it has been held that if an allotment is made either before filing statement in lieu of prospectus or the prospectus itself, the same is void though of course the sáme result will not follow if the statement is defective (*Blair Open-Hearth Furnace Co.*, (1914) 1 *Ch.* 390). The essential requisite in order to give a legal title to the shareholder is not only an application and allotment of

shares but also an entry on the register of members (*Nicol's Case,* (1885) 29 *Ch. D.* 421). Of course the allotment being complete, the company can enforce that agreement. If however an agreement was made to purchase shares from the promoters, that agreement cannot be enforced.

Minimum Subscription before Allotment

We have already seen that the prospectus of a public company offering shares to the public has to disclose the minimum subscription on which the directors may proceed to allotment and that unless and until the minimum subscription has been applied for no allotment can be made. The other point to be noted is that cheques received before allotment for application money must be cashed before allotment is made because in case they are held over and though subsequently honoured that will not do (*National Motor Mail Coach Co.,* (1908) 2 *Ch.* 228). Under the English Act of 1929 however an amendment has been effected in Sec. 39 (1) by which it is laid down that even though a cheque is received by way of application money in good faith by the company and the directors of the company have no reason for suspecting that the cheque will not be paid, the said cheque will be as good as cash in law. Our Act however stands where it was and thus in the above case the law as to payment in hard cash applies. If however the conditions as to minimum subscription have not been complied with on the expiration of 180 days after the first issue of the prospectus, all money received from applicants for shares shall be forthwith repaid to them without interest and if any such money is not so repaid within 190 days after the issue of the prospectus, the directors of the company shall be jointly and severally liable to repay that money with interest at the rate of 7 per cent. per annum from the expiration of the 190th day. This is subject to the exception that a director shall not be liable if he proves that the loss of the money was not due to any misconduct

or negligence on his part [Sec. 101 (4)]. It is further laid down that any condition requiring or binding any applicant for shares to waive compliance with any requirement of this section shall be void [Sec. 101 (5)]. In this connection the provisions in the sub-section (4) means those in the prospectus on which the applicant subscribes (*Roussell* v. *Burnham,* (1909) 1 *Ch.* 127). Sec. 102 further lays down that if an allotment made by a company is in contravention of the provision of Sec. 101, it shall be voidable at the instance of the applicant within one month after the holding of a statutory meeting of the company and not later *or in any case where the company is not required to hold a statutory meeting or where the allotment is made after the holding of the statutory meeting within one month after the date of the allotment and not later* (Amendment Act, 1936) and shall be voidable notwithstanding that the company is in course of being wound up.

"Stagging" or "Stags"

In connection with allotment, care has to be taken to see that applications are not made by what are known as "stags", *i.e.,* speculators who apply for a block of shares, paying the application money, with the hope that the shares will soon rise to premium in the market and by the time these shares are allotted to them they can unload same at a higher price, thereby making a profit. Where a company is quite confident of over-subscription it generally avoids the stags by rejecting their application and allotting to genuine investors. Those experienced in company matters know the well-known stags on the market. The objection to dealing through the stags is that their operation results in violent fluctuation in the value of shares in the market and thus the company feels considerably confused in connection with its allotments and as to the ultimate holders of shares with whom they might have to deal.

The Split Allotments

The question of stags which we considered in the above paragraph leads us to the consideration of what are called "split allotments." In the United Kingdom, particularly and even when large operations are made in India, it is noticed that in case where the issues of certain companies are very much in demand, a large number of transactions take place on the exchange against allotment letters, particularly in connection with stock exchange operators who have taken care to apply for the largest number of shares and are now unloading. If the usual method of passing entries in the various books in the names of the original allottees in the first instance and the subsequent transfers to a large number of sub-allottees among whom these shares are ultimately divided by small transfers were followed, that would involve an amount of work for the department. The method now followed with a view to prevent this is to give the allottees the right to "split allotments," *i.e.*, to renounce their allotment in favour of one or more persons. This renunciation must be done during the time stipulated by the company which runs from between four to six weeks. This results in the entries not being passed in the names of the stags, or the speculative purchaser in the first instance, but in the passing of the direct entries in the names of the genuine or more or less permanent investors among whom the stags were dividing these shares by re-selling them. All that is done is that the original allottee should hand over the letter of allotment together with his letter of renunciation in favour of the parties he has chosen. The exact legal significance of this form of work is not yet certain as no case has yet been brought to the Court of Law.

Consideration for Allotment

The shares have to be paid for either in cash or in other valuable consideration. If the shares are allotted for consideration other than cash the contract under

which it is done must be *bona fide* because though the Court does not usually inquire into the adequacy of consideration it would do so where there is room for doubt (*Re. Wragg,* (1897) 1 *Ch.* 796). There is, of course, no objection to allot shares for a future consideration as where they are so allotted for services to be rendered in future (*Gardner* v. *Iredale,* (1912) 1 *Ch.* 700). But of course there must be a limit to this rule and in one case the Court objected to an indefinite amount of shares being allotted out of future capital issue fully paid from time to time for a fixed present consideration (*Hong-Kong & China Gas Co.* v. *Glen,* (1914) 1 *Ch.* 527). It should be noted that it is a breach of duty on part of directors to issue shares to themselves and their friends at terms more favourable as to payment than those offered to the public, unless the public are expressly informed of it (*Alexander* v. *Automatic Telephone Co.,* (1900) 2 *Ch.* 56). It has also been held that a supply of goods at a future time against calls is not valid (*Pellatt's Case,* (1867) 2 *Ch.* 527). This is subject to this that where shares are issued as fully paid though not so paid, the company is estopped from denying the truth of its own statement, the innocent outsiders who received share certificates containing this statement would be protected and shares will be treated as fully paid (*Parbury's Case,* (1896) 1 *Ch.* 100), and that rule extends even to those who have bought back these shares with full knowledge of these facts (*Ex-parte Sandys,* (1889) 42 *Ch. D.* 98; *Re. New Chile Gold Mining Co.,* (1892) *W. N.* 193). In one other case though the certificate did not state the shares to be fully paid a letter accompanying did state that the holder escaped liability *Re. MacDonald Sons & Co.,* (1894) 1 *Ch.* 89). If however by inference such word as bonus was printed on the certificate or the holder had knowledge of certain facts at the time he took the share certificates that they were not paid for in cash in full they would be liable to make good the balance unpaid (*Eddystone Marine Insurance*

Co., No. 2, (1894) *W. N.* 30; *Markham & Darter's Case,* (1899) 1 *Ch.* 414). The argument that he ought to have known will not hold good. What is wanted is whether he actually and in fact knew that they were not fully paid (*Bloomenthal* v. *Ford,* (1897) *A. C.* 156). In an Allahabad Case a person who transferred his property to a new company received as part consideration an allotment of three thousand shares fully-paid. The transaction was mentioned in the memorandum of association and in the prospectus. No agreement was filed under Sec. 104 of the Indian Companies Act, 1913. On the company going into liquidation it was held that the transaction as set forth as above was perfectly legal and the vendor was a fully-paid shareholder (*Prem Beharilal* v. *S. B. Billimoria & Co.,* (1926) 48 *All.* 502).

Allotment to Infants and Lunatics

In connection with infants it has been held that though an infant may be a member he may repudiate the shares during his minority and after attaining full age (*Re. Laxon & Co., No.* 2, (1892) 3 *Ch.* 555). An infant may become a member of a company by subscribing to the memorandum of association or by transfer of shares (*Lumsden's Case,* (1868) 4 *Ch.* 31). Of course if the shares are fully-paid shares and the company a limited liability company, there should be no objection to register an infant as a shareholder unless there is some additional liability or obligation attached to the shares such as to take and pay for further shares. When there is a liability attached to the share, the company must refuse to accept the minor as a shareholder or transferee (*Symon's Case,* (1870) 5 *Ch.* 298; *Castello's Case,* (1869) 8 *Eq.* 504; *Dublin & Wicklow R. Co.* v. *Black,* (1852) 8 *Ex.* 181; *Re. Laxon & Co., No.* 2, (1892) 3 *Ch.* 555). As long as the infant remains on the register of members as a shareholder he is entitled to the benefits and liable for obligations on the shares (*Re. Laxon & Co., No.* 2, (1892) 3 *Ch.* 555). If the infant repudiates he cannot successfully

recover the money he has paid on them unless the shares were worthless and the infant did not receive any benefit from them (*Steinberg* v. *Scala* (*Leeds*),(1923) 2 Ch. 452). The fact that the transferor was ignorant of the infancy of the transferee is immaterial (*Litchfield's Case,* (1849) 4 *De. G. & Sm.* 141; *Mann's Case,* (1867) 3 *Ch.* 459 *Note; Delmar's Case,* (1868) 38 *L. J. Ch.* 85). The decisions go further and state that in case the infant happens to have transferred some of the shares, the transferor still remains liable in respect of the balance of shares which are untransferred (*Mann's Case,* (1867) 3 *Ch.* 459 *Note*). If however an infant does not repudiate the shares on attaining majority and becomes a duly constituted shareholder, the transferor is released from responsibility (*Parson's Case,* (1869) 8 *Eq.* 656; *Massey & Griffin's Case,* (1907) 1 *Ch.* 582).

With reference to the release of the transferor from his liability in case where the infant transferee has transferred his shares through a third party, it may be noted that if he has transferred in this case more than one year prior to liquidation, he cannot be placed on the B list of contributories, even though the infant's transferee is unable to pay the calls made by the liquidator (*Gooch's Case,* (1872) 8 *Ch.* 266). Frequently persons purchase shares on the stock exchange and instead of getting same transferred to their names, resell them or get them transferred to the name of an infant. Here if the transferor remains liable on the shares because of the infant transferee, the person so procuring the transfer is liable to make good the loss to him or to compensate him, though he cannot be put on the register of members as owner of the shares unless it can be proved that the infant's name was used as a *binami* or that there was some contractual relation established between him and the company (*Maitland's Case,* (1868) 38 *L. J. Ch.* 554; *Massey & Griffin's case,* (1907) 1 *Ch.* 582; *Pugh & Sharman's Case,* (1872) 13 *Eq.* 566). An infant cannot on attaining age retain the shares without accepting the

burden attaching to them (*Cork & Bandon Ry. Co.* v. *Cazenove*, (1847) 10 *Q. B.* 935).

It is very doubtful as to what time in which the infant should repudiate on attaining majority and the general principle happens to be that it should be done within a reasonable time following that event but much depends upon the circumstances of the case. However, where benefits are received after attaining majority, the right to repudiate comes to an end. In this connection the cases to be noticed are the following :—

Farrington v. *Forrester*, (1893) 2 *Ch.* 401, where repudiation was allowed after 37 years as no benefit was received. *Ebbett's Case*, (1870) *Ch.* 302 *and Mitchell's Case*, (1870) 9 *Eq.* 363 where delay of one and two years respectively destroyed the right to repudiate whereas in *Hart's Case*, (1868) 6 *Eq.* 312, three years delay was not considered sufficiently lengthy to repudiate, no benefits being derived. The position of the lunatics is more or less akin to that of an infant here and transfers by infant can only be made by an order of some Court of competent jurisdiction and by a person mentioned in the order. Transfers by lunatics or by joint holders, one of whom is a lunatic can only be made pursuant to an order in Lunacy Court and by the persons named in the order.

It is also held that it is misfeasance and a breach of trust to allot shares knowingly to an infant (*Crenver & Co., Re. Ex-parte Wilson*, (1873) 8 *Ch. Ap.* 45) and where a shareholder transfers his share to an infant or lunatic he remains liable and if his name is removed it can be restored on the register of members (*Curtis's Case*, (1868) 6 *Eq.* 455; *Wilson's Case*, (1869) 8 *Eq.* 240; *Weston's Case*, (1870) 5 *Ch.* 614). Generally speaking in all case of persons who are not *sui juris* such, as infants or lunatics, their contracts to take shares are voidable (*Lumsden's Case*, (1868) 4 *Ch. App.* 31; *Ebbett's Case*, (1870) *Ch.* 302; *Yeoland Consols*, (1888) 58 *L. T.* 922).

Allotment to Married Women

There is no objection to a married woman subscribing to a memorandum of association or to be allotted shares in her own right (*Re. Leeds Banking Co.,* (1866) *L. R.* 3 *Eq.* 781). When a married woman signs a memorandum she may describe herself after her name as "married woman" or "wife of Mr. X, Y." These shares when allotted will be shown in the register in the name of the married woman herself as her separate property unless and until the contrary is shown. Of course the directors may in connection with shares to which liabilities are attached refuse to admit a married woman as a shareholder on the ground that they may not be able to recover from her separate property the money so due when she has no separate property or very little of it provided the articles of association give them the power to reject transfers.

Allotment to a Corporation or a Joint Stock Company

A corporation may be allotted shares and become a shareholder of another corporation or joint stock company if it is authorised to hold shares or purchase same by its constitution (*Bath's Case,* (1878) 8 *Ch. D.* 334; *Re. Barned's Banking Co., Ex-parte Contract Corporation,* (1867) 3 *Ch.* 105).

Allotment to a Partnership

If a partnership applies for shares the same should not be allotted in the name of the partnership or registered in that name, but all the partners may be treated as joint holders and entered as such on the register of members. In case, however, when the name of the partnership firm is entered on the register with the consent of the partners, all partners are liable as members on the shares concerned (*Weikersheim's Case,* (1873) 8 *Ch.* 831). Where transfers are presented of shares in favour of a firm or partnership

in its firm or partnership name, the company may reject same (*Vagliano A. Collieries,* (1910) *W. N.* 187).

Allotment to a Foreigner or an Alien

There is no objection to a foreigner signing the memorandum of association and thus becoming a member of a British company so long as he is a friendly alien and not an alien enemy. A foreigner may also take shares in a joint stock company (*Princess of Reuss* v. *Bos,* (1871) *L. R.* 5 *H. L.* 176).

Forms of Contracts for Allotment and Returns

When shares are allotted for a consideration other than cash partly or fully, Sec. 104 makes it imperative that the company shall file within a month thereafter (1) a return of allotments stating the number and nominal amount of shares so allotted and the extent to which they are to be treated as paid-up and consideration of such allotment and (2) produce for the inspection and examination of the registrar a contract in writing constituting the title of the allottee to the allotment, together with any contract of sale, or for services, or other consideration in respect of which that allotment was made, such contracts being fully stamped, and filed with the registrar, copies verified in the prescribed manner of all such contracts. Where such a contract is not reduced to writing the company shall, within one month after the allotment, file with the registrar the prescribed particulars of the contract, stamped with the same stamp duty as it would have been payable if the contract had been reduced to writing. Any default made in complying with the requirements of this section makes every officer, knowingly a party, liable to a fine not exceeding five hundred rupees for every day during which the default continues. This is however subject to this, that any person liable for such a default may apply to the Court for relief and if the Court is satisfied that the omission was accidental or due to inadvertence or that on other grounds

it is just and equitable to grant relief" it may make an order extending the time for filing of such document for such period as the Court may think proper.

For Forms of Return of Allotment and Agreement of Allotment see Vol. II Appendix A and Index.

For Forms of Application to Extend Time see Vol. II Appendix B and Index.

From the above it will be seen that under Sec. 104 the contract to allot shares for a consideration other than cash need not be in writing. There is also no provision in the Act to the effect that the value of shares in absence of such a contract must be paid or payable in cash. However when a liquidator finds that a contract for an allotment of shares is not stamped and filed, the law expects him to stamp and file it at the expense of the company (*In re. X Company,* (1907) 2 *Ch.* 92).

Consequences of an Irregular Allotment

Over and above this it is laid down in Sec. 102 that the directors who knowingly contravene or permit or authorise the contravention of any of the provisions of Sec. 101 with respect of allotment, shall be liable to compensate to the company and to the allottees, respectively, for any loss, damages or costs, which the company or the allottee may have sustained or incurred thereby. This is subject to the condition that proceedings to recover such damages or costs shall not be commenced after the expiration of two years from the date of allotment. After the allotment is made, it is beyond the power of the company to avoid an allotment on the ground of irregularity, under Sec. 102, say, by paying back the application money. The result will be that the shareholder who has the sole right of avoiding this allotment under this section may prefer to keep the shares and still bring a suit against the directors who knowingly contravened the section and recover the loss occasioned to him by the irregular allotment (*Burton* v. *Bevan,* (1908)

2 *Ch.* 240). In this case it was also decided that "knowingly contravened" means contravened with knowledge of facts. If however the shareholder confirms the allotment with knowledge of the irregularity, he loses his right to contravene (*Finance & Issue Ltd.* v. *Canadian Produce Corporation,* (1905) 1 *Ch.* 37). We have already seen above that in case of application and allotment the rules as to offer and acceptance strictly apply. Thus where a person applied for shares and received a letter of allotment "not transferable" it was held that it was not an unqualified acceptance, because here a new term was imported and therefore the acceptance was incomplete, so that, the shareholder could repudiate (*Duke* v. *Andrews,* (1843) 2 *Ex.* 290). The allotment should be made under terms which are legal and if an illegal term is imported, as in one case where it was stipulated that the shares should be paid for by fees earned it was held that there was no valid allotment (*Pellatt's Case,* (1867) 2 *Ch.* 527). If the allotment is not made within a reasonable time after application, the allottee may refuse to take shares and repudiate the bargain (*Ramsgate Victoria Hotel* v. *Montefiore,* (1866) *L. R.* 1 *Ex.* 109).

One more point to be noted here is that a company's funds must be applied strictly to the carrying out of its objects, and therefore, loans made by the company to enable persons to buy its own shares have been for long suspected as being *ultra vires* on that ground. This doubt has now been settled by the new section, *viz.*, Sec. 54A (2) of the Indian Companies (Amendment) Act, 1936. Here it is laid down that *no company limited by shares other than a private company, not being a subsidiary company of a public company, shall give, whether directly or indirectly, and whether by means of a loan, guarantee the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase made or to be made by any person of any shares in the company except in certain cases in which lending of money is part of the ordinary business of a company and the*

money was lent in the ordinary course of its business. This of course does not affect the right of a company to redeem its shares as provided for in Sec. 105B. The Section 54A follows Sec. 45 of the English Companies Act of 1929. A company of course cannot purchase its own shares (*Trevor* v. *Whitworth,* (1888) 12 *A. C.* 409).

Practice and Procedure in Connection with Allotment

As soon as the allotment is made, the secretary has to see first that in case where more shares are applied for than the number allotted, letters of regret are to be forwarded to the applicants whose applications were rejected.

The shares are not allotted for various reasons. Most frequently this course has to be taken because a larger number of shares may have been applied for than are available, in which case the directors naturally select those applicants whom they consider to be the most desirable to be admitted as shareholders and reject the rest. It often happens that even though all the shares are not applied for, there may be among the applicants some who in the opinion of the directors are not desirable persons to be allowed to buy the shares of the company for one reason or another, and are thus refused allotment. Letters of regret have to be sent to those applicants whose applications are rejected. They are in the following form :—

LETTER OF REGRET.

THE BOMBAY SPINNING & WEAVING CO., LTD.

Registered Office, Esplanade Road,
Bombay, 20th August, 1937.

Karsondas Kanji, Esq.,
Share Bazar,
Bombay.

Sir,

I regret to inform you that the directors are unable to allot you any of the ordinary or preference shares of this company, in compliance with your application for 75 ordinary shares and 25 preference shares.

Please find enclosed a cheque for Rs. 1,000 being the amount paid by you on the above-mentioned application, and I shall be glad if you will sign the form of receipt at the foot of the cheque sent herewith, and present the same for payment through your bankers (with the original form of receipt attached thereto).

As the cheque contains a form of receipt, no further acknowledgment from you will be necessary.

Yours faithfully,
(Sd.) J. Fernandez,
Secretary.

Bombay, 20th August, 1937.

No. 543167.

To

The National Bank of India, Ltd., Bombay.

Pay to Karsondas Kanji, Esq., or Order, the receipt below being signed, the sum of Rupees One Thousand.

For the Bombay Spinning & Weaving Co., Ltd.,
(Sd.) D. R. Cama, *Director.*
(Sd.) J. Fernandez, *Secretary.*

RECEIPT.

24th August, 1937.

Received of the Bombay Spinning & Weaving Company, Limited, the sum of Rupees One Thousand, being the amount deposited by me on application for one hundred shares in the same.

Rs. 1,000

Stamp.

The secretary should take all the allotment letters which he has prepared and have them checked with the application and allotment sheet as well as the letters of regret. Application and allotment list shall be specially prepared for this purpose and duly filled up.

All allotments should be numbered consecutively commencing with the first allotment on the first page of the application and allotment sheets, which number is

quoted in the allotment letters. The letters of regret are numbered separately.

The Method of Recording Split Allotment Letters

Frequently, as we have seen on previous pages, a company permits the applicants to split their allotment letters into so many divisions as they desire, *i.e.*, an applicant for 500 shares when allotted the 500 shares may split his allotment into, say, four letters of 100, 150, 200 and 50 if he desires so or in any other divisions that may be convenient to him. In this case the allotment list would have to be amended a little with a view to indicate this alteration which is done by ruling out the original entry and placing a note to the effect that split letters have been issued, quoting numbers of such letters and these new letters again entered on allotment list in the proper numerical sequence, indicating against each of the splits the words such as "Splits from No. 45" and the same remark should be put on the split letters itself, *viz.*, "Split from No. 45."

Resolution of Allotment

The allotment resolution is more or less in the following form :—

"RESOLVED that 5000 shares in the capital of the company, of Rs. 500 each as mentioned in application and allotment sheets submitted to this meeting, be allotted to the persons in the said list so that each allottee shall receive an allotment of the number of the shares set against his name in the..........column of the said application and allotment sheets initialled for identification by the chairman and that the notice of such allotment shall be given to each of these allottees. Further that in case of those applicants who have not been allotted shares either fully or partially in accordance with column..........of application and allotment sheet as indicated by the words "No allotment" against their respective name as well as according to the special sheet prepared or for those to whom no allotment is made at all as identified with the initial of the secretary of the company, letters of regret be sent in due form and that the deposit paid with the application for such non allotment shares be returned to the said applicants."

APPLICATION AND ALLOTMENT SHEET

Issue of..........Shares of.............each in The Practice Co., Ltd., issued at..........per Share.

Date of Application	No. of Application	Name of Applicant		Address	Description	No. of Shares Applied for	Amount received on Application		Date of Allotment	No. of Shares Allotted	Distinctive Nos.	
		Surname	Full Christian Names				C. B. Fol.	Amount			From	To

No. of Allotment Letter	Total Amount due on Application and Allotment	Balance due on Allotment		Amount Returned to Applicant			No. of Letter of Regret	Balance due if paid up in full	Interest allowed at per cent per annum	Net Amount due	C. B. Fol.	Date Received	Amounts paid in advance of Calls			Folio in New Register of Members	No. of Certificate	Remarks
		Date	Amount	Date	C. B. Fol.	Amount							Date	C. B. Fol.	Amount			

Chairman's initials..............................

Return of Allotment

Whenever a company with share-capital makes any allotment of its shares, the company must within one month thereafter file with the registrar a return of the allotment stating the number and the nominal amount of the shares comprised in the allotment, the address and description of the allottees and the amount if any paid or due and payable on each share. It is further indicated that in the case of such shares as are fully or partly paid otherwise than in cash, the company should produce for the inspection and examination of the registrar a contract in writing stating the title of the allottee to the allotment, together with any contract of sale or any service or other considerations in respect of which this allotment is made. These contracts must be duly stamped and all such contracts verified in a prescribed manner must be filed with the registrar, together with a written statement giving the number and the nominal amount of shares so held as fully or partly paid and the extent to which they are to be treated as paid up, and the consideration for which they have been allotted. Where however at the time of allotment a proper form in writing is not ready, the company shall file with the registrar the prescribed particulars of the contract stamped with the same stamp duty as would have been payable if the contract had been reduced to writing. In case of default in this connection every officer of the company who is knowingly a party to default shall be liable to a fine not exceeding Rs. 500 for every day during which the default continues. In case of default if an application is made by the company to the Court for relief and the Court is satisfied that the omission to file the document was accidental or due to inadvertence or that on other grounds it is just and equitable to grant relief, the Court may make an order extending the time for filing of the document for such a period as the Court may think proper (Sec. 104). In a Calcutta case it was laid down that if a return of allotment is presented to the registrar after the allotted time the registrar must receive

same and fix a time for getting relief from the Court for default and on the company failing to get relief within that time the registrar shall prosecute (*In Re. Ramackers and Co., Ltd.,* (1929) 56 *Cal.* 976).

FORM OF RETURN OF ALLOTMENT.

The following is the form prescribed by our Indian Companies Act for Return of Allotment under Section 104:—

FORM VI.

RETURN OF ALLOTMENTS.

THE INDIAN COMPANIES ACT, 1913.

(See Section 104).

Filing Fee Rs. 3.

Return of Allotments from the * of 19 , to the of , 19 of the

Made pursuant to Section 104 (1).

(To be filed with the Registrar within one month after the allotment is made).

** Number of the shares allotted payable in cash............
Do. do do. ....
Nominal amount of the share so allotted................
Do. do. do. ....
Amount paid or due and payable on each such share..........
Do. do. do. ....
Number of shares allotted for a consideration other than cash.......................................
Nominal amount of the shares so allotted...................
Amount to be treated as paid on each such share............

---

* NOTE :—In making a Return of Allotments under Section 104 (1) of the Indian Companies Act, 1913, it is to to be noted that :—

1. When a return includes several allotments made on different dates, the actual dates of only the first and last of such allotments should be entered at the top of the front page, and the registration of the return should be effected within one month of the first date.

2. When a return relates to one allotment only, made on one particular date that date only should be inserted, and the spaces for the second date struck out, and the word "made" substituted for the word "from" after the word "allotments" on the front page.

** Distinguished between preference, ordinary, or other description of shares.

The consideration for which such shares have been allotted is as follows :—

Presented for filing by

Names, addresses, and descriptions of the Allottees.

Name in full	Address	Descriptio	Number of shares allotted.	
			Preference	Ordinary

Signature...................

SHAREHOLDERS' OBLIGATIONS ON SHARES AND RESERVE LIABILITY

Our Indian Companies Act of 1913, Sec. 14 (2) clearly lays down that :—

> "all money payable by any member to the company under the memorandum or articles shall be a debt due from him to the company,"

and Sec. 156 while laying down that :—

> "every present and past member shall be liable to contribute to the assets of the company to an amount sufficient for payment of its debts and liabilities and costs, charges, expenses of the winding up and for the adjustment of rights of contributories among themselves," states in sub-sec. (1) (iv) that
>
> "in case of a company limited by shares, no contribution shall be required from any member exceeding the amount (if any) unpaid on the shares in respect to which he is liable as a present or past member."

Thus it will be seen that as far as a company whose capital is divided into shares and the liability of whose members is limited to the face value of the shares they hold is concerned, once they become shareholders with full status they are bound to the company to the full amount of their shares, whether when called upon by the directors when the company is a going concern or by liquidators in case the company is in liquidation. The

wording of sub-section (1) (iv) as quoted above is according to one decision declared to be tantamount to the statement that the liability of the member or shareholder continues as long as anything remains unpaid on his shares (*Ooregum Gold Mining Co., of India* v. *Roper*, (1892) *A. C.* 125). Of course a shareholder must pay for the full amount of his shares according to the terms of the issue and the stipulations contained in the articles of association. A company may however under Sec. 49 (2) if authorised by its articles, accept from any member who assents thereto, the whole or part of the amount remaining unpaid on any shares held by him, although no part of the amount has been called up, *i.e.*, receive the calls in advance. It can also under Section 49 (1) make arrangement, if so authorised by its articles, on the issue of shares for a difference between the shareholders in the amounts and times of payment of calls on their shares. It is further enacted by Section 69 that a limited company may by special resolution determine that any portion of its share-capital not already called up, shall not be capable of being called up, except in the event and for the purposes of the company being wound up, *i.e.*, create what is known as a "reserve liability." It should be noted that if such a special resolution is passed and a reserve liability is created, the same is irrevocable, but where a reserve liability is provided for by articles, the same can be altered or revoked by a special resolution with the result that the reserve capital may be called up (*Malleson* v. *The National Insurance Corporation*, (1894) 1 *Ch.* 200). From this it arises that the reserve liability created by special resolution as provided for by Section 69 must be preserved intact for the purpose of winding up and cannot be called up or mortgaged or charged (*Bartlett* v. *Mayfair Property Co.*, (1898) 2 *Ch.* 28).

Payment of Shares in Moneys Worth

The shares can also be, with the consent of the company, payable in moneys worth, such as, in property,

goods, services or some other valuable consideration or the release of a debt or the surrender of a debenture (*Re. Wragg Ltd.,* (1897) 1 *Ch.* 796; *Gardner* v. *Iredale* (1912) 1 *Ch.* 700 *at page* 716; *Larocoue* v. *Beauchemin*, (1897) *A. C.* 358). The Courts in such cases will not enquire into the adequacy of the consideration as a general rule, because a company can, under contract law principles, make its own bargain, on the same footing as an individual, provided there is no fraud or dishonesty (*Re. Wragg Ltd.,* (1897) 1 *Ch.* 796).

Return of Shares Allotted for Consideration Other than in Cash

Here when these shares are allotted as fully or partly paid, otherwise than in cash, under Section 104 (b), a copy of the written contract constituting the allottee's title to the allotment, together with any contract of sale for service or other consideration in respect of which that allotment was made, such contracts being duly stamped, must be filed with the registrar and when such contracts are not in writing, particulars of the oral contracts as prescribed must also be filed which particulars in writing must be stamped with the same stamp duty as would have been paid in if the contract had been reduced to writing. Here a penalty not exceeding Rs. 500 for every day is provided for against every officer of the company who is knowingly a party to the default. In the question of a valid contract made by the company by which it accepts specific property or services in payment or part payment of shares, the principle that the Court will not interfere is upheld even in case where the liquidator tries or attempts to get same done (*In Re. Pell's Case,* (1869) *L. R.* 5 *Ch. App.* 11).

Shares at a Discount

The old rule of law that the shares cannot be issued at a discount, still prevails with the exception of the method provided for by Section 105A of the Indian Companies (Amendment) Act of 1936 which we have already dealt

with fully in Chap. II, because it, in effect, amounts to a reduction of the company's capital in a manner not authorised by the Act and this rule would be enforceable even in case where the market quotation for the shares already issued happens to be below par (*Ooregum Gold Mining Co.* v. *Roper*, (1892) *A. C.* 125). If a device is made by which indirectly the same result is produced, such as issuing debentures at a discount and making them convertible into shares at par, that would be also prohibited (*Moseley* v. *Koffyfontein Mines*, (1904) 2 *Ch.* 108; *Famatina Development Corporation* v. *Bury*, (1910) *A. C.* 439). A company also cannot issue its shares as a bonus in consideration of past services for which it is not liable to pay or as an inducement to take debentures of the company (*Re. Eddystone Marine Insurance Co.*, (1893) 3 *Ch.* 9; *Welton* v. *Saffery*, (1897) *A. C.* 599). Where shares are allotted at a discount or by way of gift, the person to whom they are so allotted is liable to contribute the full nominal value on the winding up of the company (*Welton* v. *Saffery*, (1897) *A. C.* 299). It is also held that even when the company is a going concern he may be made to pay up the full value of his shares (*In re. Pilkin (James) & Co., Ltd.*, (1916) 85 *L. J. Ch.* 318). A circumstance may arise when the allottee of such shares at a discount or without consideration, may be able to prove that that was done without his assenting to it and if he comes for his remedy before liquidation or before winding up intervenes, he may be saved (*Re. Almada & Tirito Co.*, (1888) 38 *Ch. D.* 415; *Midland Electric Co.*, (1889) 60 *L. T.* 666). If however he had accepted the allotment directly or indirectly he will not be entitled to any relief (*Ex-parte Sandys*, (1889) 42 *Ch. D.* 98: *Re. Pikin (James) & Co., Ltd.*, (1916) 85 *L. J.* 318. If however an innocent person purchases his shares from the person who got it at a discount or without consideration, under the impression that the shares were fully paid, he would be treated as fully paid shareholder by estoppel (*Burkinshaw* v. *Nicolls*, (1878) 3 *A. C.* 1004). If the last named

purchaser thereafter sells his shares to a transferee who had notice that the said shares were not fully paid, he will give a good title notwithstanding this fact (*Barraw's Case*, (1880) 14 *Ch. D.* 432; *Re. Gulabdas Bhaidas*, (1892) 17 *Bom.* 672). However when there is consideration either in service or property or in any way in kind, the Court will not intervene to ascertain whether it is of the same value as the nominal value of shares unless it is illusory or had an obvious money value (*Theatrical Trust*, (1895) 1 *Ch.* 771; *Re. E. J. Wragg*, (1897) 1 *Ch.* 796). Thus a company can purchase assets and pay for same in shares as is usually done in connection with the formation of good many companies so long as the transaction is not proved to be colorable and the company has not been imposed upon (*Felix Hadley & Co.* v. *Hadley*, (1897) 76 *L. T.* 161; *see also Re. E. J. Wragg cited above*).

The Party Liable

Of course the party liable in connection with unpaid shares is one who is the registered holder, irrespective of the fact whether he is the beneficial holder or only a trustee and it makes no difference whether the company had notice of the trust (*In re. Chapman & Barker's Cases Imperial Mercantile Credit Association*, (1867) *L. R.* 3 *Eq.* 361). The beneficiary of the trust or the *cestui que trust* cannot be made liable in the capacity either of a shareholder or contributory (*In re. Bunn's Case, Electric Telegraph Co. of Ireland*, (1860) 2 *De G. F. & J.* 275; *Somervail* v. *Cree*, (1879) *L. R.* 4 *A. C.* 648).

REGISTER OF MEMBERS

The register of members is the most important of all the statutory books which a joint stock company must keep and get written up-to-date in the manner required by law. Non-compliance with the requirements entails a fine on the company of not exceeding Rs. 50 for every day during which the default continues and every officer of the company who knowingly and wilfully authorises

or permits the default is liable to the like penalty. The items which the law compulsorily requires to be entered in this book under Section 31 (1) are

(*i*) the names and addresses, and the occupations, if any of the members, and, in the case of a company having a share-capital, a statement of the shares held by each member, distinguishing each share by its number, and of the amount paid or agreed to be considered as paid on the shares of each member;

(*ii*) the date at which each person was entered in the register as a member;

(*iii*) the date at which any person ceased to be a member.

Besides this the new Indian Companies (Amendment) Act, 1936 has now added a sec ion, *viz.*, Sec. 31A which provides that *every company having more than fifty members shall, unless the register of members is in such a form as to constitute in itself an index, keep an index of the names of the members of the company and shall within fourteen days after the date on which any alteration is made in the register of members make any necessary alteration in the index. There is no objection to the index being in the form of a card index, but such an index must in respect of each member contain a sufficient indication to enable the account of that member in the register to be readily found. In case of default the company and every officer of the company knowingly and wilfully guilty of same shall be liable to a fine not exceeding fifty rupees.*

The register may be kept in one or more books (*Re. Alliance Financial Corporation, Blaney's Case,* (1866) 3 *Bom. H. C. R.* 106 *O. C.*). We have already seen that in case of a firm made up of partners they should be entered as joint holders of shares. However, on this point there is some conflict in the decisions because in *Vagliano Anthracite Collieries,* (1910) *W. N.* 187, it was held that the firm was not a person and therefore it ought not to be entered on the register. However, that decision seems to be doubtful because the wording used by the Act is " member " and not person and thus in the Appeal Court decision in *Re. Weikersheim's Case Land Credit Co. of Ireland,* (1873) 28 *L. T.* 653 it was held that a firm could be entered on the register as such in its firm name. The register of members is a *prima facie* evidence of any

matter directed or authorised by the Act to be inserted in it (Sec. 40). A company if so authorised by its articles may keep in the United Kingdom a branch register of members called a British Register (Secs. 41 and 42). The date on which a member was entered is required to be stated in the register and not the date on which he became a member (Sec. 31). No notice of any trust, expressed, implied or constructive, shall be entered on the register, or be receivable by the registrar (Sec. 33). It has been laid down that an allotment of shares is merely a contract until registration of the name of the member completes it (*Re. Florence Land Co.,* (1878) 29 *Ch. D.* 421). At the same time it should be remembered that once a person is lawfully registered and is thereafter wrongfully removed his status of member continues and the removal does not in the least affect him in that regard (*Barton* v. *L. & N. W. Rail Co.,* (1889) 24 *Q. B. D.* 77; *Re. Bahia etc. Co.,* (1868) *L. R.* 3 *Q. B. Cass.* 584, 595).

Inspection of Registers

The register of members naturally begins from the date on which the company was registered and is kept at the registered office of the company where it shall be open during business hours for inspection to any member gratis and to the inspection of any other person on payment of Re. 1 or such less sum as the company may prescribe for each inspection. *The member or other person may make extracts therefrom.* This is subject to such reasonable restrictions as the company in general meeting may impose, so that not less than two hours in each day be allowed for inspection. Any member or other person may require a copy of the register or any part thereof or the list and summary required by the Act of any part thereof on payment of six annas for every hundred words or fractional part thereof required to be copied *and the company must send this copy to that person within ten days exclusive of non-working days and days during*

which the transfer books are legitimately closed. Refusal of inspection *or supply of copy* will entail a fine on the company of not exceeding Rs. 20 and to a further fine not exceeding Rs. 20 for every day during which the refusal continues, and every officer of the company who knowingly authorises or permits the refusal shall be liable to a like penalty and the Court may by order compel an immediate inspection of the register. (Sec. 36). This right of inspection is a statutory right and therefore the company must grant inspection unless the register is closed under Section 37 (*R.* v. *Beer,* (1897) 20 *All.* 126). The motive of inspection has nothing to do with the right to inspect (*Davies* v. *Gas Light & Coke Co.,* (1909) 1 *Ch.* 248). The right to inspect does not carry with it a right to take abstracts or make copies from the register, because if copies are required, they are to be obtained as provided for under Section 36 (*Re. Balaghat Gold Mining Co.* (1901) 2 *K. B.* 665). The inspection may be taken either by the party himself or his solicitor or agent (*Dodd* v. *Amalgamated Marine Workers' Union,* (1924) 1 *Ch.* 116; *Bevan* v. *Webb,* (1901) 2 *Ch.* 59, 75). This right of inspection under this Section 38 ceases on the company being wound up by or subject to the supervision of a Court, (*Re. Kent Coal Fields Syndicate,* (1898) 1 *Q. B.* 754) but is replaced by Section 241 where inspection of a company's documents by its creditors and contributories is allowed and the same right can be applied to a voluntary winding up by Section 216 (old Section 215) of the Act. The company of course has the power under Section 37 of giving notice by advertisement in some newspapers circulating in the district in which the registered office of the company is situate to close the register of members at any time or times not exceeding on the whole 30 days in each year. The object of closing the register is to suspend transfers until dividends are declared and paid and to enable the company to prepare its annual list and summary which is required by Section 22 to be filed as we shall see later

on. The register of members is *prima facie* evidence of matters by the Act directed or authorised to be inserted therein (Section 40) and being thus *prima facie* it is not conclusive (*Reese River Silver Mining Co.* v. *Smith,* (1869) *L. R.* 4 *H. L.* 64 : *Ramdas* v. *Cotton Ginning Co.,* (1887) 9 *All.* 366).

The Object of Publicity of Register

It will thus be seen that the object of keeping this register open to the public for inspection is to enable it to be inspected by any one who had dealings with the company and with a view to find out what the company's exact position happens to be as far as the liability of its members is concerned and also to ascertain the status and the type of members. The new Sec. 31A which provides for a compulsory maintenance of an Index to the register naturally aims at the easy achievement of that object in case of companies with very large number of members. The doctrine of holding out applies to a shareholder, or a person registered as a shareholder, without being a shareholder, if after knowing that it has been wrongly put there, he allows the name to continue (*In Re. Sewell's Case, Newzealand Banking Corporation* (1868) *L. R.* 3 *Ch. App.* 131). Delay of a fortnight after knowing of such wrongful admission of his name in one case was considered to be a sufficiently long delay unless there was some reasonable explanation for it (*In re. Scottish Petroleum Co., in re. Wallace's Case,* (1883) 23 *Ch. D.* 413). This inspection of the register has a value up to a certain extent, because after all the register is not a conclusive evidence as we have seen above and therefore it may happen that a member who is entered there, may have been entered wrongfully and may get himself removed; also that the shareholder who is on the register to-day, by transferring his shares to another buyer of less financial standing, may go out of the register substituting his purchaser.

Notice of Trust and Lien

As we noticed no notice of trust express, implied or constructive shall be entered on the register or be receivable by the registrar. It was held in *Societe Generale* v. *Tramways Union,* (1885) 14 *Q. B. D.* 424, *Affirmed* (1886) 11 *A. C.* 20 that a company in case of notice of trust is not liable for ignoring same, although it is suggested that the directors may be liable (See also *Simpson* v. *Molson's Bank,* (1895) *A. C.* 270). A company is not allowed to enter a memorandum of lien on the register of members (In *re. Key & Son,* (1902) 1 *Ch.* 467). Though it was held in (*Re. Perkins* (1890) 24 *Q. B. D.* 613) by Lord Coleridge in the Court of Appeal that it was very important not to throw any doubt on the principle that companies have nothing whatever to do with the relation between trustees and their *cestue qui trust* in respect of the shares of the company, it was held in *Binney* v. *Ince Hall Coal Co.,* (1864) 35 *L. J. Ch.* 363; that in order to protect the equitable rights the Court will intervene by injunction if application in such cases is made before the transfer is complete. From this it follows that if the company had a notice of equitable rights of others in the shares and thereafter it advances money on the shares or thereafter some debt is incurred by the shareholders, the company will have a priority even though the articles of association may give it a first and paramount lien in such transactions (*Bradford Bank* v. *Henry Briggs,* (1886) 12 *A. C.* 29). Thus a company cannot enforce its lien on shares held by trustees if at the time of making advance, the company knew that the said shares were held in trust (*Mackereth* v. *Wigan Codl & Iron Co.,* (1916) 2 *Ch.* 293). Of course the company is not concerned to enquire whether the trustees who are on the register as shareholders are acting within their powers while dealing with the shares (*Simpson* v. *Molsons Bank,* (1895) *A. C.* 270). The priority in giving notice to the company does not affect the priority of two charges one against another (*Societe Generale* v. *Tramways Union,* (1885) 14 *Q. B. D.*

424, *Affirmed,* (1886) 11 *A. C.* 20). We have already seen that wrongful striking off or removing member's name from the register does not deprive him of the status of a member.

Branch Register

The Act provides for a branch register in Sections 41 and 42 to the effect that a company having a share-capital may if so authorised by its articles cause to be kept in the United Kingdom a branch register of members, in this Act called a British register and further enacts that the company shall within one month from the date of the opening of any branch register file with the Registrar notice of the situation of the office where such register is kept and, in the event of any change in situation of such office or any discontinuance, shall within one month from the date of such change or discontinuance as the case may be, file a notice of such change or discontinuance. The company is liable to a fine not exceeding Rs. 50 for every day in case of default. This British register is deemed to be a part of the company's register of members which under the circumstances is called the principal register. The branch register is to be kept in the same manner in which the principal register is to be kept with the only exception that before closing the register, a notice shall be inserted in newspapers circulating in the locality where the British register is kept. The company must transmit to its registered office in India a copy of every entry made in the British register as soon as may be and must also cause to be kept at such office, duly entered up from time to time, a duplicate of its British register and the duplicate shall for all purposes of this Act be deemed to be a part of the principal register. If the company were to discontinue to keep the British register, all entries in the British register shall be transferred to the principal register. The section also gives power to the company to make such regulations as it may think fit in its articles respecting the keeping of

a British register; while entering entries in the register the date at which the person was so entered in the register has to be stated and not the date when he agreed to become a member.

Rectification of Register

The company must enter the name of a rightful shareholder on the register of members because its neglect or refusal to do its duty might involve it in paying damages. The Act under Section 38 gives power to anyone whose name has been fraudulently or without sufficient cause, entered in or omitted from the register of members or where default is made or unnecessary delay takes place in entering on the register, the fact of any person having ceased to be a member, to apply to the Court for rectification of the register. In this case the Court may either refuse the application or order rectification of the register and payment by the company of any damages sustained by any party aggrieved and make such order as to cost as it in its discretion thinks fit. In the course of this application the Court may also decide any question relating to the title of any person who is a party to the application to have his name entered in or omitted from the register where a question arises between a member or an alleged member, or between members or alleged members on the one hand and the company on the other, and generally, may decide any question necessary or expedient to be decided for the rectification of the register. This is subject to the order of the Court to direct an issue to be tried in which any question of law may be raised and appeal from the decision on such an issue was in the manner directed by the Code of Civil Procedure (1908) on the grounds mentioned in Section 100 of that Code. Here it may be noticed that as for the rectification of register if the directors acting *bona fide* do so without order of the Court there is no objection. (*Hartley's Case,* (1875) 10 *Ch. App.* 157; *Wright's Case,* (1871) 7 *Ch. App.* 55). Of course the secretary cannot alter the register

and if he does so it is a nullity (*Re. Indo-China Steam Navigation Co.,* (1917) 2 *Ch.* 100). There are cases however where though the directors remove a person from the register, that may not be sufficient protection for the person concerned and thus notwithstanding his removal he can proceed to obtain a formal order of the Court under Section 38 (*Re. Bank of Hindustan Ex-parte Martin,* (1865) 12 *L. T.* 671). It will be noticed from the wording of the above section that though it provides a summary proceeding for obtaining rectification of the register it does not deprive the party concerned of his remedy by a suit (*Reese R. S. Mining Co.* v. *Smith,* (1869) *L. R.* 4 *H. L.* 64 *on page* 80; *Bellerby* v. *Rowland & Marwood S. S. Co., Ltd.,* (1902) 2 *Ch.* 14; *Re. Indo-China Steam Navigation Co.,* (1917) 2 *Ch.* 100).

The jurisdiction here given to the Court by Sec. 38 is unlimited and not confined to the cases mentioned in the section. (*Burns* v. *Siemens Brothers D. Works,* (1919) 1 *Ch.* 225). However, the exercise of this jurisdiction is entirely discretionary and will not be exercised in a complicated or doubtful case (*Ex-parte Penny,* (1872) 8 *Ch. App.* 446; *Ex-parte Wernher,* (1888) 59 *L. T.* 579; *Ex-parte Shaw,* (1877) 2 *Q. B. D.* 463; *Ramesh* v. *Jogini,* (1920) 47 *Cal.* 901; *re. Luchmee Chand,* (1882) 8 *Cal.* 317). Here though the Court has also jurisdiction to decide a question of title under Section 83(3) it is not obliged to do so (*Ex-parte Sargent,* (1874) *L. R.* 17 *Eq.* 273; *Davies' Case,* (1876) 33 *L. T.* 834 (*case of a mortgagee*); *Union Sugar Mills* v. *Jai Deo,* (1922) 44 *All.* 151). This jurisdiction also extends to transfers lodged but not registered before liquidation, but in case where winding up has begun the order is made only on strong grounds and when it is for the benefit of the company (*Re. Indian Specie Bank,* (1916) 40 *Bom.* 134; *Ward & Garfit's Case,* (1867) *L. R.* 4 *Eq.* 189; *Re. Onward Building Society,* (1891) 2 *Q. B.* 463). In other cases the jurisdiction is exercisable irrespective of the fact whether the company is in liquidation or not and in

liquidation this power is not limited to the rectification for the settling of the list of contributories only (*Re. Sussex Brick Co.*, (1904) 1 *Ch.* 598). The order may also be made to have a retrospective effect according to same authority. The order may also be invoked by the company (*Re. Indo-China Steam Navigation Co.*, (1917) 2 *Ch.* 100). The Court really declines as between a member and the company to exercise jurisdiction under this section (*Ex-parte Parker*, (1867) 2 *Ch.* 685). In a proper case where the company is a defendant in this action for rectification, it may be ordered to give discovery of documents, such as in one case where the plaintiff alleged that he had been induced by the fraud of a director to sell shares at under-value and wanted to set aside the transfer as void and also for the rectification of the register, the company was ordered to disclose its balance sheet and the materials from which they were made up for a period of ten years preceding the date of agreement for sale of the shares (*Cory* v. *Cory*, (1923) 1 *Ch.* 90). On the same footing a shareholder may get his name removed from the register by rectification on the ground that he was induced to subscribe by fraud or misrepresentation on the prospectus, but of course he must come for his remedy in reasonable time (*Ex-parte Ward*, (1868) *L. R.* 3 *Exch.* 180; *London and Staffordshire Co.*, (1883) 24 *Ch. D.* 149). This can be done by a motion and before proceedings have been taken to wind up the company (*Muir* v. *City of Glasgow Bank*, (1879) 4 *A. C.* 337). There are cases where a delay even is not a bar to rectification as *e.g.*, where the agreement to take shares was void *ab initio* and not merely voidable (*Oakes* v. *Turquand*, (1867) 2 *H. L.* 325; *Gorrissen's Case*, (1873) 8 *Ch.* 507). The rectification can be sought under various circumstances such as the shares were issued as fully paid without contract being duly filed (*Darlington Forge Co.*, (1887) 34 *Ch. D.* 522) or where the allotment of shares was irregular (*Homer Gold Mines*, (1888) 39 *Ch. D.* 546) or where a forged transfer was acted upon (*Bahia

& San Francisco Ry. Co., (1868) *L. R.* 3 *Q. B.* 584) or where shares were improperly forfeited (*Ystalyfera Gas Co.,* (1887) *W. N.* 30) or where signatory of an underwriting letter was placed on the register and it was found that the letter did not constitute a contract (*Consort D. L. Gold Mines,* (1897) 1 *Ch.* 575) or where the shareholder's name was removed on *ultra vires* surrender of its shares (*Bellerby* v. *Rowland & M. S. Co.,* (1902) 2 *Ch.* 14).

In such matters directors are not proper parties to be dealt with as respondents and will not be made to pay costs of the motion unless they are added at their own request (*Keith Prowse & Co.,* (1918) 1 *Ch.* 487; *Copal Varnish Co.,* (1917) 2 *Ch.* 349). In voluntary winding up a liquidator may alter the register by sanctioning transfers made after the commencement of the winding up (*Taylor Phillips & Rickard's Case,* (1897) 1 *Ch.* 298). An alteration will not be made in the register if a transfer is not registered because the directors decided *bona fide* within their powers (*Alexander Mitchael's Case,* (1879) 4 *A. C.* 548). The rectification will also not be made if something remains to be done in order to complete the transfer or where according to the articles the directors must exercise their discretion and they have failed to do so (*Marino's Case,* (1867) 2 *Ch.* 596; *Walker's Case,* (1866) 2 *Eq.* 554; *In re. Hackney Pavilion,* (1924) 1 *Ch.* 276).

In connection with the question as to what circumstances would mean improper delay in removing the member's name it has been held that where the transfer was delayed and not registered at the first available directors' meeting, or was delayed because of the non-attendance of the directors it would come under that designation (*Nation's Case,* (1866) *L. R.* 3 *Eq.* 77; *Re. Manchester and Oldham Bank,* (1885) 54 *L. J. Ch.* 926; *Re. Joint Stock Discount Co., Ex-parte Reid,* (1867) 36 *L. J. Ch.* 472). But where there was no directors' meeting held before the presentation of a winding up petition and therefore the transfers were not registered, the Court held that that did not necessarily mean that there was default or

unnecessary delay (*Re. Indian Specie Bank,* (1916) 40 *Bom.* 134). However an undue delay to register a transfer does not amount to a waiver on the part of the directors who have powers under articles to reject the transfer to an irresponsible person (*Shipman's Case,* (1868) *L. R.* 5 *Eq.* 219).

In the Presidency High Courts, applications for rectification of the register under Section 38 are made by petition and chamber summons. The proviso to Section 38 of our Indian Act applies to the section generally and the right to appeal is not confined to cases within sub-section (3) but the issues must be properly raised and tried.

The correct course where a name is ordered to be removed by the Court is to draw a line through the name of the member or shareholder and put a remark to the effect that "by an order of the Court of......dated...... this name has been erased." Under Section 39 where a company is required by the companies Act to file a list of its members with the registrar, the Court, when making an order for rectification of the register shall by its order direct notice of the rectification to be filed with the Registrar.

TRANSFER OF SHARES

A shareholder has the right to transfer his shares, or any other interest, in the manner provided by the articles. The shares are movable property. (Sec. 28). This transfer is easily effected through..........filling in and signing of the transfer form. This transfer form may be either a special form provided for by the company, or the forms obtainable at stationers. The usual practice is to provide for a special form in the articles of association. The transfer form has also to be signed by the transferee. According to the usual custom of stock exchanges, when a share is sold on the market, the transferor fills in and signs a transfer form in favour of the buyer and hands over the same together with the share-certificate to the transferee. The transferee then

FORM OF REGISTER OF MEMBERS

Surname................................. Date of becoming Member.............................

Christian Name......................... Date of ceasing to be a Member.........................

Address.................................

Occupation.............................

<table>
<tr><th colspan="7">Shares Transferred</th><th colspan="8">Shares Acquired</th></tr>
<tr><th rowspan="3">Date of Registration of Transfer</th><th colspan="6">Particulars of Shares Transferred</th><th rowspan="3">Date Acquired</th><th colspan="3">Particulars of Shares Acquired</th><th rowspan="3">No. of Shares Acquired</th><th colspan="3">Paid on Shares Acquired</th></tr>
<tr><th rowspan="2">No. of Transfer Deed</th><th colspan="2">Distinctive Numbers</th><th rowspan="2">Folio in Register of Transfers</th><th rowspan="2">No. of Shares transferred</th><th rowspan="2">Amount paid on shares transferred</th><th rowspan="2">No. of Transfer Deed or Allotment</th><th colspan="2">Distinctive Numbers</th><th rowspan="2">Amount</th><th rowspan="2">C. B. Folio</th><th rowspan="2">Date</th></tr>
<tr><th>From</th><th>To</th><th>From</th><th>To</th></tr>
<tr><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

lodges this transfer, with the share-certificate, at the office of the company, and the secretary of the company brings the said application for the transfer before the next board meeting of the directors. It has been held that, unless the directors have the power to refuse to register a member specially reserved to them by the articles, this transfer must be registered at the earliest moment of time. As for example, in one case, namely *Sussex Brick Co.*, (1904) 1 *Ch.* 598 a transferee of shares in a limited company sent in his transfer to the company for registration, but for some reason or other the said registration was omitted. The company went into voluntary liquidation soon thereafter with a view to re-construct. The transferee under the impression that he was placed on the register, sent his notice of dissent to the liquidator, but the liquidator refused to acknowledge him as a member on the ground that he was not registered. The Court held that if there had been such a default, or unnecessary delay in registration as entitled the applicant to an order for rectification, the applicant was to be treated as if he were registered from the time that such a registration should have been made in the usual course. The corresponding Indian case in point is in *Re. Indian Specie Bank, Ltd.*, (1915) 17 *Bom. L. R.* 342. This, of course, applies where there is no special power left with the directors to refuse to register a transfer.

In this connection it is important to note that the old Sec. 34 of our Act has been substituted for an elaborate Sec. 34 by the Indian Companies (Amendment) Act of 1936, where it is laid down that

an application for the registration of the transfer of shares in a company may be made either by the transferor or the transferee, provided that where such application is made by the transferor no registration shall in the case of partly paid shares be effected unless the company gives notice of the application to the transferee. If no objection is made by the transferee of this transfer application within two weeks from the date of the receipt of the notice, the company must enter in its register of members the name of the transferee in the same manner and subject to the same

conditions as if the application for registration was made by the transferee. If the notice is despatched by pre-paid post to the transferee at the address given in the instrument of transfer, it shall be deemed to have been duly given and shall be made to have been delivered in the ordinary course of post. The company cannot lawfully register a transfer of shares in or debentures of the company unless the proper instrument of transfer duly stamped and executed by the transferor and the transferee has been delivered to the company along with the scrip. However where it is proved to the satisfaction of the directors of the company that an instrument of transfer signed by the transferor and transferee has been lost, the company may, if the directors think fit, on an application in writing made by the transferee and bearing the stamp required by the instrument of transfer, register the transfer on such terms as to indemnity as the directors may think fit. If the company refuses to register the transfer of any shares or debentures, the company must within two months from the date on which the instrument of transfer was lodged send to the transferee and the transferor notice of the refusal. If any default in this connection is made, i.e., sending of the notice of refusal of transfer within two months from the date on which it was lodged, it would entail a fine on the company as well as on every director, manager, secretary or officer of the company who is knowingly a party to the default. In case where a share or debenture is held by any person to whom the right to sell has been by operation of law transmitted, the rule as given in Sec. 34(3), which requires a duly stamped transfer on proper form shall not apply. Of course the rights of the company to refuse a transfer under the articles remain unimpaired by this section.

It will be seen from the above that the main object sought to be achieved by the amended section is to prevent what the Special Law Officer in his report calls "the arbitrary way in which the registration of transfer of shares was delayed." Here the section lays down a limit of two months on the ground that in England this period has been considered to be sufficient to enable companies to make up their minds in matters of transfer and in the opinion of the said officer "there is no reason why that should not be deemed sufficient here as well." In addition to this the new section further provides for a notice to be given to the transferee before the transfer is effected in case where the application for transfer is made by the

transferor and the shares are partly paid. The object here is obvious, *viz.*, to give the transferee a chance of objecting to a transfer of a partly paid share on his name, particularly because he thereby incurs the liability of having to pay the unpaid balance when calls are made.

S. (35). A transfer of the share or other interest of a deceased member of a company made by his legal representative shall, although the legal representative is not himself a member, be as valid as if he had been a member at the time of the execution of the instrument of transfer.

Where, however, the discretion is left to the directors entitling them to refuse a transfer, it has been held that as long as they exercise this discretion wisely and *bona fide* the Court shall not interfere (*Coalport China Co.*, (1895) 2 *Ch.* 404). This, of course does not mean that the directors can refuse to allow a transfer to all comers because, if they did so, they will be abusing their powers. The power to reject transfers is a trust to be exercised for the benefit of the company and should be exercised *bona fide* without being oppressive, capricious, or corrupt. The directors are not bound to give reasons, but the Court must be satisfied that they have considered the transfer and have refused under power given to them. If, however, they give reasons for refusal, the Court will consider whether they are legitimate (*In Re. Bell Bros.*, (1891) 65 *L. T.* 245; *Sree Mahant Kishore Dossjee* v. *Coimbatore Spinning & Weaving Co.*, (1902) 26 *Mad.* 79-83; *Muir Mills* v. *T. H. Condon,* (1900) 22 *All.* 410). But if this refusal to transfer any application was made because the directors knew that the company was on the point of suspending payment, the refusal was considered to be fair and *bona fide* and the directors were not held to be in default (*Alexander Mitchell's Case,* (1879) 4 *A. C.* 548). Where the articles provided that "the directors may decline to register any transfer on certain grounds and the directors shall not be bound to specify grounds. . . . . . ." interrogatories cannot be administered to the directors to ascertain the grounds upon which they refused to register

a transfer (*Berry and Another* v. *Tottenham Hotspur F. A. Co. Ltd.*, (1935) *W. N.* 155; 1 *Ch. D.* 718, see also *Duke of Sutherland* v. *British Dominion L. Cor.*, (1926) *Ch.* 746 where interrogatories were allowed). In this connection it may be noted that the purchaser of the right, title and interest of a shareholder at a Court sale is subject to same rules as apply to a private purchaser (*Manilal Brijlal Shah* v. *The Gordhan Spinning and Manufacturing Co.*, (1916) 18 *Bom. L. R.* 952). It is the frequent practice while raising money on the security of shares to execute blank transfers with a view that the party who advances money on this security may, in case of default, sell the shares filling in the name of his buyer, and thus make the transfers complete. If this deposit on shares with a blank transfer is made with a view to mortgage them, the mortgagee's position will be the same.

Blank Transfers

Frequently as we noticed above, when it is desired to give a charge over the shares on which money is borrowed, instead of mortgaging them a blank transfer form is given to the lender by the holder of the shares, duly executed by the holder, together with the share-certificates. The idea here is that in case the loan is not repaid with interest according to stipulation, the lender may recover his money by selling the shares and transferring the same by filling in the transfer form. Where such transfers are taken it is best for the lender to take the precaution to immediately give notice to the company concerned, informing them of the pledge, so that he may be protected against any advance or credit, which the company may give to the shareholder in connection with its own business and for which it may have a lien provided for it, in its own Articles (*Bradford Bank Co.* v. *Briggs,* (1886) 12 *A. C.* 29; *Mackereth* v. *Wigon Coal & Iron Co.*, (1916) 2 *Ch.* 293). It should be further noted here by the owner who has handed over the share-certificates with a blank transfer to a lender by way

of security that the lender can transfer all the title he has, but he cannot transfer or give a greater title even to an innocent third party (*France* v. *Clark*, (1884) 26 *Ch. D.* 257).

In case of blank transfers, if the person receiving same improperly fills his own name or that of another person, he does not get the title to the shares or pass any title. If he however hands over a blank transfer, the transferee does not get a better title than the transferor as he receives a blank transfer with full knowledge and belief that absolute sale had not been made (*France* v. *Clark*, (1884) 26 *Ch. D.* 257; *Williams* v. *The Colonial Bank*, (1888) 38 *Ch. D.* 388; *Fox* v. *Martin*, (1895) *W. N.* 36). The result will be the same if he receives the transfer duly filled in knowing and believing that the shares were not properly transferred (*Sheffield* v. *London Joint Stock Bank*, (1888) 13 *A. C.* 333). In case where the owner of the shares hands over a blank transfer to another for raising money, he would be bound by the acts of his agent and the person who lends same will be deemed to have notice of any limitation of the authority of the agent concerned (*Fry* v. *Smellie*, (1912) 3 *K. B.* 282; *Brocklesby* v. *Temperance B. S.*, (1895) *A. C.* 173).

With respect to blank transfers a number of cases have arisen in Bombay and Calcutta, which are of great importance. The question which had to be answered was whether a blank transfer was a negotiable instrument so that a *bona fide* buyer of shares on the market from a person who had no authority from the registered owner should get a good title *In Hazarimal Shohanlal* v. *Satish Chandra Ghose*, (1919) 46 *Cal.* 331, *Chaudhari, J.*, held that (*a*) a *bona fide* purchaser of shares from a person, who is in possession of them by fraud, does not acquire a good title to them and (*b*) share-certificates passing from hand to hand with blank transfer deeds do not thereby become negotiable instruments.

In Bombay the Appeal Court in *Abdul Vahed Abdul Karim* v. *Hasanalli Alibhai Ghasia*, (1926) 28 *Bom. L. R.*

562 laid down to the effect that the registered owner of shares by handing over share-certificates with a blank transfer duly signed by him to another person does not represent to the world that such a person is entitled to deal with the shares and therefore a *bona fide* purchaser from such a person does not acquire a good title to such shares. In this case the English cases, *viz.*, *France* v. *Clark,* (1884) 26 *Ch. D.* 257 and *Fox* v. *Martin,* (1895) 64 *L. J. Ch.* 473 were followed.

In *M. P. Bharucha* v. *Wadilal Sarabhai & Co.,* (1926) 28 *Bom. L. R.* 777 the Privy Council decided however that shares of a company are " goods " within the meaning of Sec. 76 of the Indian Contract Act, 1872 and now Sec. 2 (7) of the Indian Sale of Goods Act of 1929 reiterates that. In case, therefore, shares are sold with a blank transfer and cheque paid by the buyer in payment thereof and the said cheque is subsequently dishonoured, the vendor can sue to recover either on the dishonoured cheque or on the original price of the sale. He has no lien or claim on the shares themselves. That as soon as the shares were sold and share-certificates with the blank transfer were handed over to the buyer, the goods became ascertained goods and the property passed. With respect to the rule of the Bombay Stock Exchange that in case the cheque paid against purchase of shares is dishonoured the shares are to be returned to the vendor or resold the following day, the Court held that the said rule was not intended to make delivery of the share-certificates conditional on payment. The real purpose of the rule according to the Court was not for the purpose of perfection of contracts, or the passing of property, but for estimating promptly the damages resulting from the purchaser's failure to pay for the shares bought and accepted.

Here it may be mentioned that in case of dominion and foreign companies there is a practice of printing the form of transfer on the back of the certificate. Frequently this transfer is signed blank and passed on from buyer to

buyer on the same footing as a share warrant. It has been held that such a blank transfer confers both a legal and equitable title on the holder (*Stern* v. *Regina*, (1896) 1 *Q. B.* 211; *Colonial Bank* v. *Cady*, (1890) 15 *A. C.* 267). Thus in case a broker who is given the certificate for sale pledges same without authority with a bank who receives same without notice, the bank would be protected (*Fuller* v. *Glyn, Mills, Currie & Co.*, (1914) 2 *K. B.* 168).

Certified Transfer

We have seen above that according to stock exchange practice, the seller of shares has to hand over his share-certificate together with the transfer duly executed by him, to the buyer against cash. Now in case of companies who do not issue separate share-certificates for each share held, this is not possible, and thus, A who may be holding ten shares in a company for which he holds one certificate in which he is declared a holder of the said ten shares, wishes to transfer or sell four out of them and retain six, what he has to do is to go to the company's office and lodge his certificate for ten shares with the secretary and get his transfer "certified." This operation of certifying amounts to a remark being written by the secretary on the margin of the transfer form to something like the following effect :—

Certificate for ten Rs. 1,000 ordinary shares has been lodged in the office of this company.

The Bombay Trading Co., Ltd.,
(Sd.) P. Rustomji,
Secretary.

This certified transfer can now be handed over on the Stock Exchange by the seller to the buyer against cash, and as the transfer form is thus certified, the share-certificate need not accompany it as in the case of an ordinary transfer. It must have been noticed that the certification of the transfer amounts to nothing more than an acknowledgment by the secretary of the receipt of the

certificate in deposit with him. In one case namely, *Bishop* v. *Balkis Consolidated Co.*, (1890) 25 *Q. B. D.* 512, it was held that even if no certificate is lodged, and the secretary carelessly placed his remark on the transfer, the company will not be responsible. It was also held in the same case, that the certification did not amount to any representation that the proposed transferor had a good title. Certification, however, has been taken in the words of *Lindley, L. J.* in the *Bishop's Case* referred to above as "incidental to the transaction in the ordinary business way, as a part of the legitimate business of all companies having capital divided into shares which are transferable by deed or other instrument." The *Bishop's Case* was followed in Bombay in the case of a similar transaction by *Jenkins, C.J.*, (*L. W. J. Rivett Carnac* v. *The New Mofussil Co., Ltd.*, (1901) 3 *Bom. L. R.* 846). In Bombay the practice is that when the shares are bought on the open market the transfer deed is signed by the seller and the buyer. The seller's broker lodges the transfer together with the share-certificates at the company's office. Certain formalities are gone into at this office and ultimately a *pucca* receipt is issued in the following form :—

From :—The N. M. Co., Ltd., To, R. Carnac Esqr.,

Bombay, 8th July, 1896.

Received for Transfer the following Share-Certificates with transfer deeds duly executed.

No. 1007.
No. 1588.

Total two shares.
(Sd.) H. B. Mama,
Transfer Clerk.

N.B. :—This receipt shall be presented within one week from this date, when share-certificates will be returned. The company will not hold responsible for the safe custody of the above shares beyond one week from this date.

This *pucca* receipt is given to the buyer's broker who hands over the same to the buyer and obtains the price.

Here the buyer who bought the shares and paid against this *pucca* receipt found out later, that the transfer form was forged. The company refused to place him (the buyer) on the register. The buyer pleaded that in view of the *pucca* receipt the company was estopped from denying his rights. The Court held that "the *pucca* receipt implies no more than certification" and therefore "no estoppel such as the plaintiff claims is created." In another case, *viz.*, *George Whitechurch* v. *Cavanagh,* (1902) 1 *A. C.* 117 it was held that, where the secretary has fraudulently certified the transfer, *i.e.*, stated that the certificate was lodged with the company, whereas in fact, it was not, the company was not estopped from denying that it was so lodged. This is because it was laid down that in the case of certification, a company does not authorise the secretary to do more than give a receipt for certificates that are actually lodged. It has also been held that no secretary of a company, nor its manager, has any authority to pass transfers (*Chida Mines Ltd.* v. *Anderson,* (1905) 22 *T. L. R.* 27). The registration of the transfer is important because the title of the transferee is not complete until his name is placed on the register of members. Again, in one case where a secretary who had once certified the transfer through negligence returned the share-certificate to the transferor, which enabled the latter to fraudulently make a second transfer, the company was not held to be liable (*Longman* v. *Bath Electric Tramways,* (1905) 1 *Ch.* 646). The point to be considered is whether the directors issued the share-certificate believing the forged transfer to be properly signed, and whether, relying upon this new certificate, the innocent outsider purchases the share and parts with his money. If so, the original shareholder whose signature was forged has a right to be placed on the register, and the company has in that case to compensate the innocent third party for loss, if any, sustained. The company may, in its turn, get itself indemnified by the person who brings the forged transfer and gets himself originally registered even though the said

person did so in good faith (*Sheffield Corporation* v. *Barclay*, (1905) *A. C.* 392; *Davis* v. *Bank of England*, (1824) 2 *Bing.* 393).

In a suit by the transferee to enforce registration the transferor was a necessary party as he had to be removed from the register (*Ontario Jockey Club Ltd.* v. *Samual McBridge*, (1928) 30 *Bom. L. R.* 1329).

It may be added here that in case where the shares are mortgaged, the same may be done by actual transfer of shares to the mortgagee who gets the same duly registered subject to, of course, the agreement that on repayment of the capital and interest, the said mortgagee, shall retransfer the said shares to the mortgagor. Here the mortgagee becomes a member during the time that the mortgage continues. The other method is by depositing the share-certificates with the mortgagee together with the blank transfer as we have seen above. In case of the blank transfer, the mortgagee shall notify the company in lieu of distringas with the result that the company gives notice to the mortgagee, in case he is called upon to transfer the said shares, or in case where the company wishes to pay dividends in respect of such shares.

Refusal of Transfers

We have seen that the directors are not bound to give reasons where the articles are so worded but if the articles gives them a discretion to refuse transfers to persons they disapprove the refusal must be made on grounds personal to the proposed transferee (*Bede S. S. Co.*, (1917) 1 *Ch.* 123). In case the power to refuse is limited in the articles to certain specific or particular grounds the directors may be ordered by the Court to state their grounds of refusal (*Sutherland* v. *British Dominion Corporation*, (1926) *Ch.* 746). The directors are not bound to state the grounds or reasons for their refusal unless the articles specifically require them to do so (*Berry and Stewart* v. *Tottenham Hotspur Co.*, (1935)

Ch. 718). Where however a company has the power to decline transfer and the vote is equally divided the transfer must be registered (*Re. Hackney Pavilion,* (1924) 1 *Ch.* 276). Unless specially strong powers are given, a transfer cannot be refused on the ground that its registration would bring in the trustee in bankruptcy of the transferee on the register (*Sutton* v. *The English & Colonial Produce Co.,* (1902) 2 *Ch.* 502). Where the directors keep away from a meeting with the deliberate idea that there may not be a quorum and thereby a particular transfer to which they object may not be registered, the Court has interfered and ordered the register to be rectified (*Re. Copal Varnish Co.,* (1917) 2 *Ch.* 349). Unless a transfer is duly passed by the Board it cannot be registered (*Chida Mines* v. *Anderson,* (1905) 22 *T. L. R.* 27). Until registered the transferee has only equitable as against the legal right. In case where there are calls in arrears at the time of transfer, the company can sue transferee on the usual form of transfer. When a transfer is required under seal, as in case of some English companies, it must be duly filled in, sealed and delivered and a blank transfer will not do because the deed must be complete before it is executed (*Powell* v. *London & Provincial Bank,* (1893) 2 *Ch.* 555).

Irregular Transfers

We have seen that the custom and practice of the market, as expressed by the stock exchange rules, do not throw on the seller the obligation to get the buyer registered and in case of refusal of the registration of the transfer, the transferor is a trustee of the shares for the transferee (*Loring* v. *Davis,* (1886) 32 *Ch. D.* 625; *Hardoon* v. *Belilios,* (1901) *A. C.* 118). If the buyer is particularly anxious to bind the seller to procure him registration, he must get a special agreement to that effect. When an irregular transfer is made, the transferee cannot escape responsibility specially when he has acted as a member and received dividends (*Straffon's Executor's*

Case, (1852) 22 *L. J. Ch.* 194; *Cunninghame* v. *The City of Glasgow Bank,* (1879) 4 *A. C.* 607). A transfer is said to be irregular where it is not in accordance with the regulations of the company and in spite of this fact it is not a nullity (*re. Taurine,* (1884) 25 *Ch. D.* 118). Where an irregular transfer has been registered and the transferee has acted upon it as valid for a number of years, the company cannot avoid same and put the transferor on the register (*Re. Taurine,* (1884) 25 *Ch. D.* 118; *Murray* v. *Bush,* (1873) *L. R.* 6 *H. L.* 37). When a transferee has not signed the transfer or agreed to take shares and if placed on the register notwithstanding, the transfer shall not be effective (*Bunn's Case,* (1860) 29 *L. J. Ch.* 913). Where a transfer is approved of by the directors acting according to the best of their judgment they are responsible for loss if any which may arise through the party proving thereafter to be financially unsound (*Faure Electric Accumulator Co.,* (1889) 40 *Ch. D.* 141; *Chappell's Case,* (1871) 6 *Ch.* 902). Simply because the transferee happens to be already a holder of shares in the same company is not the ground that further shares shall not be transferred to him where discretion is given in the articles of the directors to that effect (*Re. Dublin North City M. Co.,* (1909) 1 *Ir. R.* 179). The directors however cannot refuse a transfer on the ground that the transferee did not agree to support a proposed change in the mode of remunerating the company's agents (*Kaikhosro* v. *Kurla Spinning & Weaving Co.,* (1892) 16 *Bom.* 80).

A contract for the sale of shares only means a contract to deliver and not an actual sale (*Heseltine* v. *Siggers,* (1848) 1 *Exch.* 856). Even where the directors may not have the right to reject the transfers in the articles, they can set aside same when they discover that it is not an out and out transfer reserving no beneficial right to the transferor (*Discoveror's Finance Corporation, Lindlar's Case,* (1910) 1 *Ch. at pages* 316-317). There is of course no objection to the articles as we have

noticed in the case of private limited companies by which the member may be required to sell his shares at a price fixed in the manner described in the articles (*Borland's Trustee* v. *Steel Brothers & Co.*, (1901) 1 *Ch.* 279). When a transfer form contains the number of shares sold or transferred and the certificates bore these numbers, but afterwards it was found out that these numbers were already registered in the names of the other parties, it was held that there was a total failure of consideration and thus the purchaser could recover his consideration back from the seller (*Platt* v. *Rowe,* (1909) 26 *T. L. R.* 49).

When transfers are made by way of gift, the transfer form has to be filled in in the usual way and the proper stamp duly paid. When shares are sold the implied contract is that the buyer agrees to indemnify the seller from any calls or liability which may arise with respect to shares subsequently to the transfer (*Kellock* v. *Enthoven,* (1874) *L. R.* 9 *Q. B.* 241). When a contract to transfer is broken the measure of damages is the difference between the contract price and the market price at the date of the breach (*Jamal* v. *Molla Dawood & Co.*, (1916) 1 *A. C.* 175). Transfers during the liquidation of the company, whether voluntary or compulsory, cannot be made without the sanction of the Court and the Court generally will not grant the sanction, unless a transfer happens to be incomplete because of that it has not been registered prior to the winding up. (*Emmerson's Case,* No. 2, (1866) *L. R.* 1 *Ch. App.* 433). As we have already seen a voluntary liquidator has power to register a transfer after winding up (*Re. National Bank of Wales,* (1897) 1 *Ch.* 298).

Notice of Trust and Equitable Rights

It should be further noted that according to Sec. 33 a notice of any trust express, implied or constructive, cannot be entered on the register or be receivable by the registrar. This rule has been introduced because it is

very necessary for the protection of companies who may otherwise be drawn into litigation in connection with breach of trust etc. This principle laid down under Sec. 33 is frequently reiterated in the articles of association by a special clause for the benefit of the allottees who may have to deal with these articles. Thus if the shares are held by executors or trustees their names cannot be entered in their representative capacity on the register. The executors or trustees may get the said shares transferred to their own personal names in which case personal liability will attach to them in connection with the unpaid balance where the shares are not fully paid-up. In this case naturally, the shares being held in the personal name, the trustee is the shareholder, and the company may exercise a lien upon such shares for a debt due to it by the *cestui que trust* (*Res Perkins,* (1890) 24 *Q. B. D.* 613). However, the equitable rights for such shares or interests will be recognised and protected by the Courts, as in one case where shares were mortgaged under an equitable mortgage, the mortgagee was held to be entitled to sue the company for the recovery of dividends payable in respect of the mortgaged shares (*Binney v. Ince Hall Coal Co.,* (1866) 35 *L. J. Ch.* 363). This principle is now so extended that in a later case the equitable mortgagee of shares was given a priority over the company which had attached the shares under a decree for a debt incurred by the shareholder after the debt on the equitable mortgage, though the company had no notice of the charge (*Bank of Butterfield* v. *Golinsky,* (1926) *A. C.* 733 (*P.C.*) If the directors of the company accepted a transfer with the knowledge of the circumstances rendering it wrong to accept the same they will be personally liable though the company may be protected (*Societe Generale de Paris* v. *Walker,* (1885) 11 *A. C.* 20; *Simpson* v. *Molson's Bank,* (1895) *A. C.* 270).

Of course where the company has no notice of trust it is entitled to enforce its lien or other rights against trustees without regard to the claim of the *cestui que*

trust (*London and Brazilian Bank* v. *Brocklebank*, (1882) 21 *Ch. D.* 302). In connection with the executors or their representatives, Sec. 35 lays down that a transfer of either shares or other interests by a deceased member of a company may be made by his authority by his legal representative, although the legal representative is not himself a member, as if he had been a member at the time of execution of the instrument of transfer. Thus the executors, if they do not wish to take any responsibility on themselves and if the shares are left as legacies, should transfer them to the legatees concerned so that their names may be entered on the register of members as shareholders. There are of course articles in some companies which do not permit the shares to remain in the name of the deceased shareholders, but compel the representative holders either to take the shares in their own name by getting them transferred or to transfer same to nominees. In the absence of such articles there is nothing to prevent these representative holders to permit the shares to remain in the name of the deceased shareholders and only to operate on dividend forms by endorsing though in their representative capacity and thus recover dividends for the estate of the deceased. Frequently the executors make an agreement with the company by which they accept liabilities attached to the shares and this agreement should be in writing.

Restrictions on Transfer

The share is a personal property and therefore the holder of it may transfer the same to any one he likes subject to the restrictions, if any, in the articles of association of the company. It is however to be remembered that the position of a public company is on a different footing here, while compared with that of a private company. In the case of a private company restrictions on transfers is the essence, because the shares in such companies have all to be held within the circle of the maximum of fifty members exclusive of those in the

employment of the company. We have already seen how in the case of private companies there are certain restrictions imposed by the articles. Besides this most of the companies whose capital is divided into shares have a clause in their articles of association by which the right of transfer of shares is limited in the sense that it is open to the board of directors to reject such transfer to persons whom they do not consider to be responsible and even in case of fully paid-up shares they can refuse transfers and assign no reason, if the article so empowers them. These restrictions are no doubt put in the articles of association concerned, and the language in which that is done is of considerable importance here, because Courts will construe same very strictly. The usual clause in this connection runs as follows :—

Form of Article with Power to Refuse Transfer

"The directors may decline to register any transfer of shares without assigning any reason therefor. They may also decline to register any transfer of shares upon which company has *lien*."

Besides the above, very wide and general powers are frequently added to it: "For such refusal to transfer the director shall not be bound to give any reason;" though according to some authorities these words are implied. In a Bombay case it was laid down that (1) directors refusing are not bound to state reasons and in the absence of evidence they must be taken to have acted *bona fide* (2) in order to vitiate the exercise of their power their action must be proved to be arbitrary and capricious (*The Matheran S. Tramways Co.* v. *B. N. Lang,* (1931) 33 *Bom. L. R.* 184). Some companies have a little more qualified power of refusal given to them as in the following precedent :—

Form No. 2 of Article with Power to Refuse Transfer

"The board may, at their own absolute and uncontrolled discretion decline to register or acknowledge any transfer of shares, and in particular may so decline in any case in which the company has a lien upon the shares of any of them, or whilst any share-

holder executing the transfer is, either alone or jointly with any other person or persons, indebted to the company on any account whatsoever, or whilst any moneys in respect of the shares desired to be transferred or any of them remain unpaid or unless the transferee is approved by the board. The registration of a transfer shall be conclusive evidence of the approval by the directors of the transferee."

The question in what form this power to refuse transfer should be drafted, must depend on the promoters and the managing agents under whose instruction this work is done. Too many restrictions on the power of shareholders who sell and transfer their shares may, it is argued by some, result in hesitation on part of the buyers on the market and therefore may reflect on the market value of such shares. However in a market like ours in India, with the bulk of the shareholders who are thoroughly ignorant as to these restrictions imposed, the article such as the one quoted above does not enter into their calculations. The directors should decline to give reasons for their refusal while exercising their powers under the articles, because if they were to give a reason that may be taken as the basis for a suit, by the disappointed transferee in order to test how far the reasons given by the directors are valid (*Bell Bros.*, (1891) 65 *L. T.* 245). In such cases where the refusals are made without reason being granted, the test will be whether the power has been exercised capriciously or wantonly (*Ex-parte Penny*, (1873) 8 *Ch.* 446). In another case it was further decided that if the directors refuse to give effect to a transfer, they are not bound to send notice of such refusal to the transferor (*Gustard's Case*, (1868) 8 *Eq.* 438). There have been cases where a director has wilfully absented himself with a view to prevent transfers and in such cases the Courts have ordered registration because the directors could meet and form a quorum (*Copal Varnish Co.*, (1917) 2 *Ch.* 349). It must be however noted that the Courts take the view that the clauses restricting transfers must be construed

reasonably and where the articles contain restrictions upon the rights of shareholders and their executors to transfer and the shareholder by his will created a trust of his shares in the company and the two acting executors thereafter arranged an additional trustee to whom they executed a transfer the Court held, on the company refusing to register the transfer, that the transfer was justified under the articles (*Hobson, Houghton & Co.*, (1929) 1 *Ch.* 300).

TRANSFER AND RECTIFICATION OF REGISTER.

When the articles of association give power to the directors to refuse transfers, the transfer does not confer the transferee a legal title, but an equitable title, because a legal title can only be acquired in every case only on the directors accepting the transfer and placing the transferee on the register of members as a shareholder (*Torkington* v. *Magee*, (1902) 2 *K. B.* 427). This rule applies with equal force to a transfer which is not voluntary but has been given in execution of a decree of a Court (*Nagabhushanam* v. *Sri Ram Ramchandra Rao*, (1922) 45 *Mad.* 537). A transfer which is not registered does not thus become operative and a transfer which is not registered does not operate as a trust (*Amarendra* v. *Monimunjari*, (1921) 48 *Cal.* 986). Again a transfer has to be registered without unnecessary delay and a transfer which is not open to objection must be registered in the usual course at the first convenient meeting of the directors, otherwise the delay is unnecessary (*Joint Stock Discount Co.* (*Nation's Case*), (1866) 3 *Eq.* 77; *Hill's Case*, (1869) 4 *Ch.* 769*n*.). In case of unnecessary delays the aggrieved party may move for the rectification of the register with a view to remove the name of the transferor and place the transferee's name in its place. This may be done even in the case where liquidation supervenes. See also *In Re. The Indian Specie Bank Ltd.*, (1916) 40 *Bom.* 134 where this was done here in liquidation as there was no unnecessary delay in registra-

tion as the company went into liquidation before transfers could be given effect to in reasonable time.

In the case of winding up also Sec. 194 gives power to the Court to rectify the register of members at the instance of any contributory or of the company or the liquidator. Of course Sec. 38 is the usual section for a going company for this purpose where it is laid down that :—

If (*a*) the name of any person is fraudulently or without sufficient cause entered in or omitted from the register of members of a company; or

(*b*) default is made or unnecessary delay takes place in entering on the register the fact of any person having ceased to be a member.

The person aggrieved, or any member of the company, or the company, may apply to the Court for rectification of the register.

The jurisdiction given above is unrestricted but its exercise is discretionary and is never exercised in a doubtful or complicated case (*Ex-parte Penny,* (1872) 8 *Ch. App.* 446; *Ex-parte Wernher,* (1888) 59 *L. T.* 579; *Ex-parte Shaw,* (1877) 2 *Q. B. D.* 463; *Ramesh* v. *Jogini,* (1920) 47 *Cal.* 901).

The Sec. 38 (3) gives the further right to the Court to decide any question relating to the title of any person who is a party to the application to have his name entered in or omitted from the register, whether the question arises between members or alleged members, or between members or alleged members on the one hand and the company on the other, and generally, may decide any question necessary or expedient to be decided for rectification of the register. The Court may even direct an issue to be tried on which any question of law may be raised with a right of appeal under Sec. 100 of the Code of Civil Procedure, 1908. Though the Court here has jurisdiction to decide a question of title it is not bound to do so (*Ex-parte Sargent,* (1874) 17 *Eq.* 273; *Union Sugar Mills* v. *Jai Deo,* (1922) 44 *All.* 151). The jurisdiction of the Court in this connection extends to both the transfers lodged but not registered

before liquidation as well as to those executed after winding up began (*Ward and Garfit's Case,* (1867) *L. R.* 4 *Eq.* 189). In the last case it must be for the benefit of the company (*Re. Onward Building Society,* (1891) 2 *Q. B.* 463).

Rectification of Register—Where Ordered

The following are the cases where rectification of the register has been ordered by the Court where :—

(1) The applicant's name was improperly entered in the register and then struck off on a forfeiture of shares (*Re. Bank of Hindusthan Ex-parte Los,* (1865) 12 *L. T.* 690).

(2) An applicant was induced to purchase shares by misrepresentation in the prospectus (*Stewart's Case,* (1866) 1 *Ch. App.* 574; *Ashew's Case,* (1874) 9 *Ch. App.* 664).

(3) The company neglected or improperly refused to register a transfer (*Stranton Iron Co.,* (1873) 16 *Eq.* 559)

(4) The transfer was not signed by the transferee (*Heritage's Case,* (1869) *L. R.* 9 *Eq.* 5).

(5) Shares were improperly forfeited or the register was improperly altered with a view to assert the company's lien (*In Re. Ystalyfera Gas Co.,* (1887) *W. N.* 30).

(6) The shares were allotted on the application of an agent who had no authority (*Ex-parte White,* (1867) 16 *L. T.* 276); or where the applicant was registered as a holder of shares which were in fact irregularly allotted to him (*Homer District Consolidated Gold Mines,* (1888) 39 *Ch. D.* 546).

(7) The application for shares was a conditional application and the said condition remained unfulfilled (*Re. London and Exchange Bank Limited,* (1867) 16 *L. T.* 340; *Wood's Case,* (1873) *L. R.* 15 *Eq.* 236; *Ramanbhai v. Ghasiram,* (1918) 42 *Bom.* 595).

(8) The real owner's name was removed by the com-

pany acting on a forged transfer (*Re. Bahia & San Francisco Railway Co.*, (1868) *L. R.* 3 *Q. B.* 584).

(9) A director deliberately did not attend meetings of the Board in order to form a quorum, thus preventing the passing of a transfer (*In Re. Copal Varnish Co.*, (1917) 2 *Ch.* 349).

(10) There was a dispute between the seller and the purchaser of the share (*Ex-parte Shaw*, (1877) 2 *Q. B. D.* 463).

(11) The shares were entered in the name of a nominee without the said nominee's knowledge or consent (*Pugh & Sharman's Case*, (1872) *L. R.* 13 *Eq.* 566).

(12) The signatory of an under-writing letter, which did not constitute a contract, had been placed on the register (*Consort Deep Level Gold Mines*, (1897) 1 *Ch.* 575).

FORM AND EXECUTION OF TRANSFER

The usual practice is, as we have seen, to provide a form in the articles which can be obtained from the company's office on which the transfer is to be executed and the directors in such cases have the right to refuse to register a transfer if the prescribed form is not followed or used, but this right is subject to limitations. The most important point is that the execution of the transfer is properly made. Where there are joint holders, the transfer form should be executed by all the joint holders and if the signature of any of these joint holders happens to be forged the whole transfer will be void (*Barton* v. *L. & N. W. Ry. Co.*, (1890) 24 *Q. B. D.* 77). It has also been held that it is not the duty of a transferor vendor to procure registration of the transfer, but all he has to do, as we have already seen before, is to hand over the transfer form duly executed, together with relevant share-certificates or its equivalent to the buyer against payment (*Skinner* v. *City of London Marine Insurance Corporation*, (1885) 14 *Q. B. D.* 882). However until registration is effected the transferor is in the position of a trustee

of shares for the transferee and thus must vote for the shares by signing proxy as the transferee buyer may require him to do (*Lording* v. *Davis,* (1886) 32 *Ch. D.* 625; *Hardoon* v. *Belilios,* (1901) *A. C.* 118).

Some articles of association like the Table A give the form in which the signatures on the transfer form are to be attested by witnesses, in which case that formality must not be omitted. Even if the articles permit, an oral transfer cannot be registered for the simple reason that it would mean the avoidance of the stamp duty. Care should be taken in connection with the filling up of the transfer forms that the consideration, distinctive numbers of shares and full names, addresses and occupations of all parties to the transfer are given, though in the last-named case if it could be proved that the company has means of supply itself with the names it shall not invalidate the transfer (*Letheby & Christopher,* (1904) 1 *Ch.* 815). A transfer form must be properly stamped according to the requirements of Article 62 of the Indian Stamp Act, 1899 and in case of each province an enhanced duty made by the province concerned must be looked into. The obligation to prepare a transfer being on the purchaser, the Stamp duty is by custom payable by him (*Birkett* v. *Cowper Coles,* (1919) 35 *T. L. R.* 298).

When the transfer comes into the office, it is the duty of the secretary to take care to see that it is properly filled in all particulars and stamped before he places them before the directors. It has been held that here if the secretary makes an error he being a responsible person, the directors are not personally liable if they accept his investigation to be sufficient (*Dixon* v. *Kennaway,* (1900) 1 *Ch.* 833).

Forged Transfer

We have already seen that a forged transfer gives no right or title (*Simm* v. *Anglo-American Telegraph Co.,* (1879) 5 *Q. B. D.* 188); See *Hunsraj* v. *Ruttonji,* (1900) 24 *Bom.* 65). But if the person receiving this forged transfer

24

has relied upon the company's certificate made out in the name of the forger he can sue the company for damages (*Bahia & San Francisco Ry. Co.,* (1868) *L. R.* 3 *Q. B.* 584). A company which removes the name of the true owner from the register on a forged transfer can be compelled to replace him there paying him all the dividends that may have been declared in the interval (*Barton* v. *North S. R. Co.,* (1888) 38 *Ch. D.* 458; *Barton* v. *The London & N. W. R. Co.,* (1889) 24 *Q. B. D.* 77), but however a person who deposits a forged transfer, whether the alleged transferee or the broker even though he does so in good faith, is liable to the company for any loss they may suffer (*Sheffield Corporation* v. *Barclay,* (1905) *A. C.* 392). A company can on its own, remove the name of its transferee when it finds that he is acting on a forged transfer (*Simm* v. *Anglo-American Co.,* (1879) 5 *Q. B. D.* 211) but of course it cannot do so if a *bona fide* purchaser has acted on a certificate issued by it on a forged transfer. Even where the secretary has fraudulently forged a certificate and issued it without the authority of the directors for his own purpose as we have seen before, the company is not stopped from denying the secretary's title (*Ruben* v. *The Great Fingall Consolidated,* (1906) *A. C.* 439).

In case of the true owner of shares whose name has been removed from the register on a forged transfer, he can sue the company alone or jointly with the transferee with a view to get his name reinstated in the register, but if he sues the company alone, the company will be given leave to serve a third party notice of claim for indemnity on the transferee (*Carshore* v. *North Eastern Ry. Co.,* (1885) 28 *Ch. D.* 344; *Barton* v. *The London & N. W. R. Co.,* (1888) 38 *Ch. D.* 144). The limitation begins to run against this true owner in favour of the company from the time the company refused to replace him on the register, and not prior to that, as there was no complete cause of action (*Barton* v. *North S. R. Co.,* (1888) 38 *Ch. D.* 458).

Balance Receipt or Ticket

Where a certificate of shares is lodged containing a larger number of shares than those which are sought to be transferred, the practice is that in some cases the secretary of the company concerned issues to the seller, or his broker, a receipt for the balance of shares which receipt is called the "Balance Receipt." This receipt means that the seller, in due course, is entitled to receive a certificate for the balance of untransferred or unsold shares. Care should be taken to see that such balance receipt is signed by some responsible officer, such as the secretary or the registrar of the company. This receipt is in some cases also known as "Balance Ticket." It is usually given in the following form :—

THE BOMBAY TRADING COMPANY, LIMITED.
Esplanade Road, Bombay.
BALANCE TICKET.

No..........

........19....

Certificate No........

No. of Shares........

Total............

Certified.........

....

Balance..........

Distinctive Numbers on Balance Ticket.

From.	To.

Issued to..............

Balance Certificate ready....

(Perforation)

THE BOMBAY TRADING

Esplanade Road, Bombay.
BALANCE TICKET.

No..........

........19....

This is to certify that a Balance of.......Shares in the Bombay Trading Company, Limited, numbered from...... to........ both inclusive, now stands in the Company's Books in the name of...........The Balance Certificate will be ready on................

NOTE:—No Balance Certificate will be issued, or Transfer certified, until this Ticket is lodged with the Company.

Resolution Passing Transfer

RESOLVED :—That transfers Nos. 756 to 820 inclusive be and are hereby passed and the secretary is instructed to affix the seal to the new certificates issued in the names of the respective transferees in the manner provided by article No.........and that the names of the said transferees be entered in the register of members forthwith.

THE SHARE CERTIFICATE

We have seen that when a shareholder is entered on the register of members he is given a certificate known as the share-certificate which is, in accordance with Sec. 29, *prima facie* evidence of the title of the member to the shares, or stock, specified therein, if issued under the common seal of the company. The share-certificates are virtually speaking the title-deeds of the member (*Societe Generale de Paris* v. *Walker,* (1886) 11 *A. C.* 20 *on page* 44). The certificate "is a declaration that the person, in whose name the certificate is made out and to whom it is given, is a shareholder in the company and it is given by the company with the intention that it shall be so used by the person to whom it is given and acted upon in the sale and transfer of shares." (*Cockburn, C.J., in the Bahia and S. F. Ry. Company,* (1868) 3 *Q. B.* 584 *at page* 595). From this it follows, as we have already seen under the head of transfer, that if an innocent third party buys the share in the market relying on the certificate issued by the company on a forged transfer, he will be entitled to compensation. This is because though the company cannot register the transferee, it cannot deny the truth of the statements made by it in its certificate. In this connection it may be further noted, that according to Sec. 108, every company is bound to complete and have ready for delivery, the certificates of all shares and debentures and debenture stock, allotted, or transferred within three months after the said allotment of such shares,

debentures, or debenture stock, unless the conditions of the issue of such shares, or debentures, provided otherwise. This section has to be strictly followed or otherwise, all officers of the company who are knowingly party to such a default, are liable to a fine not exceeding Rs. 50, for every day during which the default continues. The rule with regard to the certificate being *prima facie* evidence applies in case of genuine certificates issued by the company and not to those cases where the said certificates are forged. In one case where the secretary forged the signatures of the directors of the company and fraudulently affixed the seal of the company, it was held that the company was entitled to deny the certificate (*Ruben* v. *Great Fingall Consolidated Co.*, (1906) *App. Cas.* 439). This is because a seal without authority is a forgery and even the doctrine as to a third party not being bound to see that in internal management the officers carried out their duties strictly according to regulations of the company does not apply here being a case of a forged document (*South London Greyhound Race Courses, Ltd.* v. *Wake*, (1930) *W. N.* 243). We have also seen that each share in the company having a share-capital should be distinguished by its appropriate number (Sec. 28). The certificates, besides giving the number and the name of the shareholder, states the nominal value of the shares and the amount actually paid up. It may be further noted that the certificate only shows the legal title to the shares and a person who buys and gets the shares transferred in his name may still be defeated by a previous equitable title, such as a mortgage. A simple deposit of certificate as a security for a debt without a transfer or memorandum will also constitute an equitable mortgage of the shares (*Harold* v. *Plenty*, (1901) 2 *Ch.* 314). For this purpose a scrip certificate is not a share-certificate but is on the same footing as a letter of allotment.

The Form of a Share Certificate

The following is a form of a share-certificate :—

No. 1234—1243.

THE BOMBAY SPINNING & WEAVING CO., LTD.

Stamp

This is to certify that Mr. Jivanji Pragji of 15, Churchgate Street, Bombay is the holder of 10 shares numbered 1234-1243 inclusive, in the above company, subject to the provisions of the memorandum and articles of association of the company; and that the sum of Rs. 100 per share has been paid in respect of each of the said shares.

Given under the common seal of the said company, this 1st day of September, 1936.

(Seal)

D. R. Cama,
Solomon Issac,
Thakersey Gordhandas,
Directors.

J. Fernandez, *Secretary.*

No transfer of any of the above-mentioned shares can be registered without production of this certificate.

The following is a form of the Share Warrant :—

SHARE WARRANT

No. of Shares............ No..........

The A. B. & C. Company, Limited.

(Incorporated under the Indian Companies Act, 1913.)
Churchgate Street, Bombay.

NOMINAL CAPITAL Rs............

Divided into..........Shares of Rs..........each.

This warrant is to certify that the bearer is the proprietor of............fully paid-up shares of Rs..........each numbered as per margin, in the A. B. & C. Company, Limited. This warrant is issued subject to the rules and regulations of the Company's articles of association, and to the conditions endorsed on the back of this warrant.

Given under the common seal of the company, this.......... day of..........one thousand nine hundred and..........

Nos.	
From.	To.

....................*Director,*

SEAL

....................*Secretary.*

.... (Perforation) ....

The A. B. & C. Company, Limited.

Talon for a fresh supply of coupons for.

No.........

Warrant to bearer representing....shares.

The bearer of the above warrant will receive in exchange for this talon a fresh supply of coupons when all the attached coupons have fallen due for payment.

.... (Perforation) ....

4. No........

The A. B. & C. Company, Limited.

Dividend Coupon No. 4.

On........shares included in the share warrant numbered as above, payable according to advertisement to be issued by the company.

Rs........

...........*Secretary.*

(Perforation)

3. No........

The A. B. & C. Company, Limited.

Dividend Coupon No. 3.

On........shares included in the share warrant numbered as above, payable according to advertisement to be issued by the company.

Rs........

...........*Secretary.*

.... (Perforation) ....

2. No........

The A. B. & C. Company, Limited.

L. S.

Dividend Coupon No. 2.

On........shares included in the share warrant numbered as above, payable according to advertisement to be issued by the company.

Rs........

...........*Secretary.*

(Perforation)

1. No........

The A. B. & C. Company, Limited.

Dividend Coupon No. 1.

On........shares included in the share warrant numbered as above, payable according to advertisement to be issued by the company.

Rs........

...........*Secretary.*

Share Warrants

A limited company may, if so authorised by its articles, with respect to any of its fully paid shares, or stock, issue under its common seal a share warrant, stating that the buyer is entitled to the stock or shares, specified therein and may provide for the payment of future dividends on the said shares, or stock, included in the warrants either by coupons or otherwise. These share warrants are transferable by delivery to the buyer thereof (Secs. 43, 44). These warrants will pass from hand to hand on delivery, and the purchaser need not make any enquiry as to the title of the person who sells the said shares and who may be handing over the said warrants. If a holder of a share warrant wishes to get it altered into a share-certificate, he may, if the articles of the company permit, surrender same for cancellation and on that step being taken, the holder's name may be entered as a member in the register of members. (Sec. 45). The holder of a share warrant has the status of a member if the articles of the company so provide. But the holding of share warrants for the requisite number of shares will not be allowed to be taken as a qualification for acting as a director if the articles of the company lay down certain number of shares as the requisite director's qualification. (Sec. 46). When a share warrant is issued to a member on his request, the company must strike out of its register of members the name of the member, and instead enter on the register the fact of the issue of the warrant, placing a statement as to the number of shares, or stock included in the warrant, distinguishing each share by its number and adding the date of such an issue. (Sec. 47).

It has been held that if a company has articles authorising it to issue a share warrant instead of shares which are not fully paid, the same shall be illegal but it shall not vitiate the registration of the company (*Reuss (Princes of)* v. *Bos,* (1871) *L. R.* 5 *H. L.* 176). In India the issue of share warrants is not popular, neither is it in England for the simple reason that stamp duty is very

heavy. In India it is one and a half times the duty payable on a conveyance for a consideration equivalent to the nominal amount of the shares specified in a warrant. It is also an offence under the Indian Stamp Act, 1899 to issue a share warrant not duly stamped. (Article 59, Schedule I, Section 62 (2) Indian Stamp Act, 1899).

A private company is not permitted to issue a share warrant. [Sec. 43 (2)]. According to mercantile custom share warrants to bearer are negotiable instruments (*Webb Hale & Co.* v. *Alexandria Water Co.*, (1905) 21 *T. L. R.* 572).

The bearer of a stock or share warrant must produce such warrant before he can exercise any of the rights of a member in respect of said stock or shares (*Wedgwood Coal & Iron Co.*, (1877) 6 *Ch. D.* 627). Frequently articles of association provide that the holders of share warrants who wish to attend a meeting or exercise their voting power, if any, must deposit the share warrants with the secretary of the company a certain number of days prior to the date of the holding of such meeting. It has also been held that where there is a contract to sell shares *i.e.*, registered shares, the delivery of share warrants will not do (*Iredell* v. *The General Securities Corporation*, (1916) 33 *T. L. R.* 67).

Procedure in connection with dealings with Share Certificates

In connection with share-certificates it should be remembered that they are very important documents of title and are considered as goods under the Indian Sale of Goods Act, 1930 which Act applies to all the sales of these certificates. The Act itself in Sec. 28 lays down that the shares or other interest of any member in a company shall be movable property transferable in the manner provided by the articles of the company and it further lays down that each share in a company having a share capital shall be distinguished by its appropriate number. Again it is not necessary that a certificate of share should

be issued only after all the calls or instalments on same are paid. The Indian Companies Act, 1913, requires under Sec. 108 that every company shall, within three months after allotment of any of its shares, debentures or debenture stock, or three months after the registration of transfer of any such shares or debenture stock, complete and have ready for delivery the certificate of all shares or debentures. The only exception being where at the time the shares were issued there was a special condition of issue published by which it was provided that the certificates will not be issued within three months but would take a specified longer period. In absence of this, the company and all officers of the company guilty of the default are liable to a fine not exceeding Rs. 50 for every day during which the default continues. The articles usually provide for the payment of shares by instalments and the common practice is to provide for a certain amount to be paid with the application between allotment and the rest by calls. It is also frequently provided that the calls shall not be made within certain intervals in order to encourage people to apply for larger number of shares than they may be ordinarily willing to go in for. It should also be noted that under Sec. 101 (1) the amount payable on application of each share shall not be less than 5 per cent. of the nominal amount of the share. There is of course no objection to the shares being paid for with the consent of the company in money's worth instead of money, *i.e.*, in property, goods, services or some other valuable consideration. They may also be paid in what is called in law the equivalent of cash, *e.g.*, the release of a debt, or the surrender of a debenture. This is actually done in practice by issuing fully or partly paid shares under special agreements to the vendors who sell property and assets belonging to the company or for remunerating promoters and others for services rendered to the company.

In connection with the issue of certificates the practice is to take back from the shareholder the receipts

which were originally issued by the company for payment on application, allotment and the calls as the case may be and against them issue a duly sealed share-certificate or to write to the shareholder through post, or otherwise to the effect that the share-certificates were ready and can be had from the company's office in exchange for these documents. The secretary also usually writes in this letter that in case the certificate is lost in course of transmission, the company would not be liable. Of course the certificates would be sent usually in a registered cover with "acknowledgment due." The usual practice is to get the certificates printed and bound in book form with counterfoils and consecutively numbered. They are then filled in and handed to the shareholders concerned, the counterfoils being retained in the cover indicating the number, name and other particulars with regard to the certificate issued. The secretary should see that before a certificate is issued it is checked by some responsible officer because any inaccuracy as to the number of shares, etc., might involve the company into damages or compensation or loss in some other form.

Frequently applications come in for issuing of duplicate certificates in place of lost or mislaid ones. This is only done after receiving from the shareholder a letter of indemnity and in some cases even advertising in local papers as to the loss at the cost of the shareholder. In case the original certificates are found after the duplicate certificate has been issued, one of these certificates, either the original or the duplicate will have to be cancelled and the circumstances under which the same were cancelled will have to be carefully noted or endorsed in the cancelled certificate and then properly filed. The cancellation should be thoroughly done preferably by perforation, though the usual practice in many cases happens to be to put a rubber stamp with the word "cancelled" across it. Usually a small charge is made of a rupee or so for the issue of a duplicate certificate.

In this connection it should be noted that the usual

form declaration taken from the shareholder declaring his loss of certificate is as follows :—

I.......................................of.............
....do solemnly and sincerely declare that I am the holder of.............................
Shares, numbered..........................to..................
to...................to....................to..................
to......................to.................to..................
............in the...
....................................that I have caused diligent search to be made for the certificate for the above-mentioned shares and I have caused all reasonable endeavours to be made to discover the same but have been unable to find the same, and I therefore verily believe that the said certificate has been lost or mislaid by me. I also declare that the said shares have not been assigned or in anywise charged or encumbered by me, and that I am now absolutely and beneficially entitled to the said shares for my own use, free from all encumbrances.

And I make this Solemn Declaration conscientiously believing the same to be true.

Declared at.................................

This..................day of...........19....

The indemnity form usually in connection with this, which is taken from the shareholder, is more or less in the following form :—

INDEMNITY TO COMPANY IN CASE OF LOSS OF CERTIFICATE

Stamp.

To the...
....Limited, and to the Directors of the said Company.

DEAR SIRS,

The original certificate of title dated the.....................
day of.....................relating to the..................shares of..................each numbered..............to..............
inclusive in the above-named company of which (1).............
......the proprietor having been (2).............(3)..............
..........request you and the said company to issue to (4)........
....................a fresh certificate of title for such shares and in consideration thereof (3)....................hereby undertake and agree with you and the said company and the directors for the time being of the said company if the same shall at any time hereafter be recovered, and to indemnify and save harmless the

said company and the directors and proprietors thereof from and against all actions proceedings, loss, charges, damages, expenses, claims and demands which may be brought or made against the said company or the directors or proprietors thereof or which the said company or the directors or proprietors thereof shall or may sustain or be put to by reason of your consenting or of the said company consenting to issue such fresh certificate of title or in consequence of your permitting or of the said company permitted at any time hereafter a transfer of the above shares or any of them without the production of the original certificate above referred to.

Date............

Name.......................
Address.....................
Occupation....................

(3)..of............

....in the

Town of.........................concur in the above request and

guarantee the performance by the said............................

of the above undertaking.

Signature.....................

(1) I am or we are.
(2) Lost or mislaid.
(3) I or we.
(4) Me or us.

Indemnity form in case of loss of Dividend Warrant is as follows :—

INDEMNITY TO COMPANY IN CASE OF LOSS OF DIVIDEND WARRANT

To the Directors of

....Limited.

DEAR SIRS,

The warrant issued to (1)...................for the dividend amounting to Rs.............payable on the..........of........

......................19......for the year ending the.............
................of.............19......, in respect of..............
shares, numbered...............to..........inclusive in the above-named company, of which (2)................the proprietor having been (3)................(4)................request you to issue to (1)..........a fresh warrant for the same dividend and in consideration thereof (4)..............hereby undertake and agree with you and the said company and the directors for the time being of the said company to deliver up the original warrant to the said company if it shall at any time hereafter be recovered, and to indemnify and save harmless the said company, and the directors and shareholders thereof, from and against all actions, proceedings, loss, charges, damages, expenses, claims and demands which may be brought or made against the said company, or the directors or shareholders hereof, under or in respect of the said warrant so lost or mislaid or which the said company, or the directors or shareholders thereof, shall or may sustain or be put to by reason of your issuing the said new warrant or otherwise howsoever.

Date............

Name........................

Address......................

Occupation...................

Witness to the Signature hereof.................................

(1) Me or us.
(2) I am or we are.
(3) Lost or mislaid.
(4) I or we.

BONUS SHARES

Frequently "bonus shares" are issued by a company either fully or partly paid out of its reserve fund accumulated from profits. The idea here is to capitalise this reserve instead of paying it out in cash. It is argued by economists that the issue of bonus shares is wiser than permitting large reserve funds to be exhibited on balance sheet, because this accumulation may call for reduction of the prices of the products of the company concerned on the ground that they were making abnormal profits. The accountants argue that even if that were not so, the issue of bonus shares is the logical adjustment

made in account, because the reserve fund is usually used and invested in the company itself and the assets and properties as exhibited on the balance sheet are proportionately representing the reserve fund on the liability side in as much as they were purchased out of the accumulation in the reserve fund. Where there are preference shareholders who are only entitled to a certain percentage of profits the surplus is divisible among the ordinary or the deferred shareholders. Thus bonus shares naturally issued to the latter class which is entitled to the balance of profits. The legal effect of the issue of bonus shares is the payment of dividend in the form of shares instead of in cash. A good many companies provide for the issue of bonus shares in their articles in which case the procedure laid down there should be followed.

The usual procedure is to close the register of members for a certain period with a view to ascertain the names of those who are entitled to those bonus shares. These bonus shares should be issued either at par or at premium, but of course the universal practice is to issue same at par. There are some rare cases where the shareholders are given the option of either taking shares or cash. When the resolution is passed for the purpose of issuing the bonus share the usual practice is to appoint either a shareholder or a director or somebody else to act as the agent of the shareholder for the purpose of entering into a contract with the company. If the contract is not desired to be made, the company can allot the shares according to the requirements of Sec. 104 (2) where it is laid down that when such a contract to allot shares for a consideration otherwise than cash is not reduced in writing the company shall within one month after the allotment file with the registrar the prescribed particulars of the oral contract with the same stamp duty as would have been payable if the contract had been reduced to writing and these particulars shall be deemed to be an instrument within the meaning of the Stamp Act of 1899 and the registrar may, as a condition of filing the parti-

culars, require that the duty payable thereon be adjusted under Sec. 31 of the Indian Stamp Act of 1899.

It frequently happens that a shareholder or member is entitled to receive one share for so many held by him, say five. In this case to a person who holds less than five a certificate called "fractional certificate" is issued. These fractional certificates are not share-certificates, but are issued either with a view that the shareholder may sell that certificate to some other shareholder on the market or otherwise purchase sufficient number of fractional certificates to make up one complete share and thereby get himself registered as a shareholder for that share.

The following is a form of fractional certificate :—

FRACTIONAL CERTIFICATE

Stamp

The A. B. & C. Company, Limited.
(Incorporated under the Indian Companies Act, 1913.)

Churchgate Street, Bombay.

NOMINAL CAPITAL Rs..............

Divided into............shares of Rs..........each.

Issue of.............shares of Rs............each.

This is to certify that the bearer of this fractional certificate, representing one............th|rd of one fully paid............ share of Rs................, upon presenting it with such other fractional certificates as shall make up one fully paid........... share of Rs............shall be entitled to an allotment of one fully paid...........share of Rs..........in the capital of this company, with this proviso; That on or before the.........day of.............next this fractional certificate, together with the

other fractional certificates making up one fully paid share shall be lodged at the offices of the company.

Dated this................day of..............19....

By order of the Board.

Entd.................   ....

Secretary.

NOTE :—This fractional certificate cannot be registered, nor can it participate in any dividend declared, until it has been exchanged with other fractional certificates for one fully paid share.

Please sign the form on the back of this certificate and return it, with the necessary other certificates, to the company's offices.

NEW SHARE ISSUE PRO-RATA

Frequently in the case of prosperous companies when there is a new share issue made, the existing shareholders or members naturally desire that they should be given the first option of purchasing these shares. The result is that to them also fractional certificates would be issued in case where they do not hold the requisite number of shares entitling them to the purchase of one complete share. The principle here followed is more or less the same as in the above case of split share-certificates issued in the case of bonus shares. The resolution passed in this connection must state the amount of the new issue and its class defining the rights of that class and the terms on which the said shares are to be issued say one to every ten or otherwise. The resolution generally provides as to how the balance of share issued and not taken up by existing members is to be dealt with.

There are cases where the fractional issue is avoided and shares are only purchasable by those who are qualified to purchase the same by their holding. The register of members will naturally be closed for the time being. A list will have to be prepared by the secretary showing the names of the shareholders entitled to purchase these new shares and arrangement should be made with the bankers

to receive the cash in a special account paid against the purchase of such an issue. Special letters are sent out in this connection more or less in the following form :—

FORM OF RENUNCIATION LETTER

THE BOMBAY SPINNING AND WEAVING COMPANY, LIMITED

15, Esplanade Road,
Bombay, 1st September, 1936.

To,

Naoroji Bomanji, Esq.,
Tamarind Lane, Fort, Bombay.

INCREASE OF CAPITAL

SIR,

As a member of the company you are entitled to an allotment at par of 50 new ordinary shares about to be issued in accordance with the special resolution passed on the 28th August, 1936, being at the rate of two new ordinary shares for every four shares now held by you.

Unless I hear to the contrary meanwhile, the 50 ordinary shares in question will be allotted to you on the 15th September, 1936.

Should you desire to renounce your right to such allotment in favour of some other person, please be good enough to sign the letter of renunciation below, and have it forwarded to the office on or before 10th September, 1936. This letter is not to be detached.

Yours obediently,
J. Fernandez,
Secretary.

LETTER OF RENUNCIATION

Stamp

To

THE BOMBAY SPINNING & WEAVING CO., LTD.

Being entitled to an allotment at par of 50 ordinary shares of Rs. 1,000 each in the above company, I hereby renounce my

right to such allotment and hereby request you to allot such shares to :—

(Full name) Abdul Husain Taki, Esq., Merchant,
(Address) Chuckla Street, Bombay.

(Signature) Naoroji Bomanji,
(Date) 7th September, 1936.

LETTER OF ACCEPTANCE.

To the Bombay Spinning & Weaving Company, Limited.

I agree to accept the above 50 ordinary shares, and to pay the calls thereon, and desire to be entered on the company's register of members in respect thereof.

(Signed) Naoroji Bomanji,
(Address) Tamarind Lane, Fort, Bombay.
(Description) Engineer.
(Date) 7th September, 1934.

When the replies are received they have to be brought forward before the Board of Directors to be formally accepted and the shares formally allotted. The necessary entries in register of members will then be made in due course, as well as the entries in the financial books of company. The next step of course will be the preparation and issue of the new certificates for the new shares.

CHAPTER IX

Membership of a Company

SHARES AND INCIDENTS CONNECTED WITH THEM (*Continued*)

Law Applying to Share-certificates

We have already seen that a share-certificate under the common seal of the company is a *prima facie* evidence of the title of the member to the shares or stock specified therein. (Sec. 29).

Section 108 of the Indian Companies Act further provides that :—

(1) Every company shall, within three months after the allotment of any of its shares, debentures or debenture stock, and within three months after the registration of the transfer of any such shares, debentures or debenture stock, complete and have ready for delivery the certificates of all shares, debentures, and the certificates of all debenture stock allotted or transferred unless the conditions of issue of the shares, debentures or debenture stock otherwise provide.

(2) If default is made in complying with the requirements of this section, the company, and every officer of the company who is knowingly a party to the default, shall be liable to a fine not exceeding fifty rupees for every day during which the default continues.

From the above section it will be noticed that the words " unless the conditions of issue of the shares, debentures or debenture stock otherwise provide " are to be found in the sub-section (1) of the section which means that if more time is to be taken in the issue of these certificates, the same should be mentioned in the articles of association and also in the prospectus to form one of the conditions of issue. Table A, Clause 6, is a specimen of the article which reiterates this branch of law and the usual practice is to have an article inserted in the company's articles of

association where more time is reserved for the issue of share-certificates in more or less the following term :—

"Every member shall be entitled without payment to receive within six months after allotment or registration of transfer (unless the conditions of issue provide for a longer interval) one certificate under the seal for all the shares registered in his name specifying the number and denoting numbers of the shares in respect of which it is issued and the amount paid-up thereon; provided that in the case of joint holders the company shall not be bound to issue more than one certificate to all the joint holders and delivery of such certificate to any one of them shall be sufficient delivery to all. Every certificate shall be signed by one director and countersigned by the managing agents or some other person nominated by the directors for the purpose."

The above clause gives, as will be noticed, ample time and protection to the officers who would otherwise be liable to a fine not exceeding Rs. 50 for every day during default under sub-section (2) of Sec. 108. The share-certificates must be stamped with an adhesive postage and revenue stamp or coloured impression of two annas under Article 19 of the Indian Stamp Act, 1899. The certificates must be numbered and the distinctive numbers of the shares must also be stated on the certificates. Of course the certificate must be sealed in the terms of the articles of association. We have already seen that once a company issues a share-certificate even under a false transfer and an innocent person acting on the certificate buys shares, the company is estopped from denying the accuracy of the statement in its own certificates. (*Rex. Bahia & San Francisco Ry. Co.*, (1868) 3 *Q. B.* 584) and if that person relying upon the said certificate buys the shares and loses its money, the company is liable for damages. The measure of damages in such cases is the value of the shares at the time the company declined to recognise the purchaser as a shareholder, with interest at the usual Court rate, or the actual loss which the shareholder has sustained owing to this refusal. On the same principle if the certificate states that the shares are fully paid, the company will be estopped from denying this

statement, unless the shareholder, when he took the share, knew that it was not fully paid (*Burkinshaw* v. *Nicolls*, (1878) 3 *A. C.* 1004; *re. London Celluloid Co.*, (1888) 39 *Ch. D.* 190; see also *Bloomenthal* v. *Ford*, (1897) *A. C.* 156. *Rowland's Case*, (1880) *W. N.* 80; *Markham and Darter's Case*, (1899) 1 *Ch.* 414). If the transferee, however knew or had notice that the representations made in the certificates are not correct, he cannot invoke the doctrine of estoppel in his favour (*Crickmer's Case*, (1875) *L. R.* 10 *Ch. App.* 614, see also *In re. Hall (A. W.) & Co.*, (1887) 37 *Ch. D.* 712). As the certificates are evidence of the legal title only to the shares, a prior equitable interest may defeat the title, *e.g.*, if a trustee of shares transfers them in fraud of the rights of the beneficiaries, the prior equitable rights of the beneficiaries will prevail if notice thereof be given to the company before the transfer is completed (*Shropshire Union Ry.* v. *R.*, (1876) *L. R.* 7 *H. L.* 496; *R. D. Sethna* v. *National Bank of India*, (1912) 36 *Bom.* 334), but if however the purchaser of shares takes the precaution to get himself registered as a holder and thereby completes his title he will be safe against all equitable rights of which he did not have any notice prior to that event (*Guy* v. *Waterloo Bros.*, (1909) 25 *T. L. R.* 515). If however the certificate itself is forged the question would stand on entirely different ground (*Ruben* v. *Great Fingall Consolidated*, (1906) *A. C.* 439).

The company also should not insert on the certificate any memorandum as to lien because in strict law the certificate must be a mere statement of ownership (*In re. W. Key & Son Ltd.*, (1902) 1 *Ch.* 467). As soon as the certificates are ready, the secretary should write a letter advising the shareholder to call at the office of the company in order to exchange the said certificate with the receipts for application, allotment and call money paid, if any. A deposit of a share-certificate without transfer or memorandum will constitute an equitable mortgage of such shares (*Harold* v. *Plenty*, (1901) 2 *Ch.* 314). Frequently for the simplicity of identification the share-

certificates are also issued in different colours for different types of shares such as preference, ordinary, deferred, etc., as is the case with application, allotment as well as call letters with which we have already dealt. The script certificate stands on a different footing because it is issued where shares are payable on instalments at short dates and very nearly correspond to the letter of allotment. These script certificates are ultimately to be exchanged for regular full share-certificates. Similar script certificates are also issued in connection with debentures. Frequently there are provisions in a company's articles of association, particularly in case of private companies compelling a shareholder, under certain specific circumstances, to transfer his shares to particular persons, at a particular price, which articles are not repugnant to absolute ownership or as standing to perpetuity. Thus there is nothing repugnant to the bankruptcy law in case the articles of association provide that in event of bankruptcy the shareholder shall sell his share to a particular person, at a particular price, provided the said price is fixed for all persons alike and is shown not to be less than the fair price which might otherwise be obtained (*Borland's Trustee* v. *Steel Bros. & Co., Ltd.,* (1901) 1 *Ch.* 279).

In case a purchaser of shares was made to rely on a certificate issued to him by the company and thus he did not take action in time with the result that it was too late to get redress against the wrong doer, the company was held estopped (*Dixon* v. *Kennaway & Co.,* (1900) 1 *Ch.* 833). The directors who issue a certificate of shares or stock which do not exist, or for the issue of which the company has no power, are personally liable in damages on and implied warranty of authority to any person who acts relying on such certificates (*Firbank's Executors* v. *Humphreys,* (1887) 18 *Q. B. D.* 54).

On the same principle where shares were issued at discount by the directors and the certificates were made out as fully paid, the directors were held to be liable to compensate the company (*Hirsche* v. *Sims,* (1894) *A. C.*

654). In cases where the certificates are worn out, or defaced, or lost, a provision is made in the articles for issue of new certificates in lieu thereof, as will be noticed from the series of model articles given hereunder, but it should be remembered that the doctrine of estoppel, of which we have seen so much above, throws a heavy responsibility on the company in this direction, particularly where a new certificate is issued without cancellation of the old, or without making sure that the old one was entirely destroyed.

A specimen form of share certificate is given on the next page. On the reverse of this certificate frequently columns are kept for recording the endorsements of calls paid from time to time. This is done in the following form :—

CALLS RECEIVED

Date	No. of Call	Amount per Share	Total Amount Paid	Signature of Authorised Officer of Company

TRANSFER CERTIFIED OR LODGED

NOTE :—This endorsement is lodged for the company's purposes only, and must not be written upon.

Date of Certification or Lodgment	Name of Transferee	No. of Shares	Distinctive Numbers		Transfer No.	New Certificate No.
			From	To		

FORM OF SHARE-CERTIFICATE

A Share-Certificate is generally given in the following form :—

The A. B. C. Company, Ltd.
Churchgate Street, Bombay.
Share-Certificate

No....... ....19...

Name.........................

Address.........................

....

....

No. of Shares.................

Nos. From...................

To..................

Fol............ Initials.......

Posted.

Date.................

Signed by.....................

(Perforated)

The A. B. C. Company, Ltd.

Churchgate Street, Bombay.

No.......

Received from

The A. B. C. Company, Ltd.

Certificate No.........

for..........................Shares,

numbered............................

to...................................

Signature...........................

(Perforated)

SHARE-CERTIFICATE

No.......... No. of Shares............
Class of Shares............

The A. B. & C. Company, Ltd.
(Incorporated under the Indian Companies Act, 1913)
Registered Office : Churchgate Street, Bombay, 1
Capital Rs...........................
Divided into...................Shares of Rs..................each, and.............. Shares of Rs.................each.

—— : o : ——

This is to certify that Mr.................. of.....................is registered as the holder of...........Shares of Rs............. each, numbered as per the margin, in the A. B. & C. Co., Ltd., pursuant to the provisions of the Memorandum and Articles of Association of the said Company, and upon each of the said Shares the sum of Rs......... ....has been paid up.

From	To

Given under the Common Seal of the Company, this...............day of ....19......

..................Director.
..................Secretary.

The object of the certificate is not only to evidence the title of the holder of the shares mentioned therein as the owner, but also to facilitate dealings by shareholders in connection with their shares. The Indian Companies Act, 1913, Section 29 defines a share-certificate as :—

"A certificate, under the common seal of the company, specifying any shares or stock held by any member, shall be *prima facie* evidence of the title of the member to the shares or stock therein specified."

Further Section 108 lays down as follows :—

(1) Every company shall, within three months after the allotment of any of its shares, debentures or debenture stock and within three months after the registration of the transfer of any such shares, debentures, or debenture stock, complete and have ready for delivery the certificates of all shares, the debentures, and the certificates of all debenture stock allotted or transferred, unless the conditions of issue of the shares, debentures or debenture stock otherwise provide.

(2) If default is made in complying with the requirements of this section, the company, and every officer of the company who is knowingly a party to the default, shall be liable to a fine not exceeding fifty rupees for every day during which the default continues.

It will be thus seen that the company is bound to give to every member a certificate for shares held by him and the articles also provide for same. According to Section 29 a share-certificate is a *prima facie* evidence of title, and thus, until the contrary is proved the person whose name it bears as the proprietor of the shares mentioned therein will be taken to be the rightful owner of same. We also see from Section 108 that the share-certificates must be ready for delivery within three months after the allotment, or registration of any transfer of the shares unless the articles of association, or the conditions of issue of shares or debentures or debenture stock otherwise provide. It is usual in articles of modern companies to provide for a longer duration, particularly in cases of companies who have issued a very large number of shares of small denominations, certificates of which could not be

prepared within the short time suggested by this section. The section makes it penal to break this regulation as to the issue of share-certificates in time. The share-certificates must be stamped with two annas adhesive stamp postage or revenue or coloured impression (Article 19, Indian Stamp Act, 1899). The certificates must be numbered consecutively and must also in their turn state the distinctive numbers of shares, the name of the holder of the shares and must be sealed in accordance with the requirements of the articles of association. If the company issues the certificates to a wrong person acting on a forged transfer or through some other cause it is estopped from denying the accuracy of the statement in it against the person who relies on it while purchasing the shares or advancing money on same (*Re. Bahia & San Francisco R. Co.*, (1868) 3 *Q. B.* 584; *Dixon* v. *Kennaway,* (1900) 1 *Ch.* 833; *Balkis Consolidated* v. *Tomkinson,* (1893) *A. C.* 396; *Ottos Kopje Diamond Mines*, (1893) 1 *Ch.* 618). Thus if the certificates state that the shares were fully paid, the company would be estopped from denying that statement, unless the shareholders concerned knew that the shares were not so fully paid (*Burkinshaw* v. *Nicolls,* (1878) 3 *A. C.* 1004; *re. London Celluloid Co.*, (1888) 39 *Ch. D.* 190; *African Gold Concessions. re. Markham and Darter's Case,* (1899) 2 *Ch.* 480). As we have already seen if the certificate is forged by the secretary for his own purpose, that will not bind the company (*Ruben* v. *Great Fingall Consolidated,* (1906) *A. C.* 439). If however the secretary alone is authorised to sign a certificate and he does so fraudulently without authority from the directors, the principal being liable for the fraud of the agent committed within the scope of his authority whether the same is for the benefit of the principal or not, the company would be liable (*Lloyd* v. *Grace Smith & Co.*, (1912) *A. C.* 716). A share-certificate is not a negotiable instrument or a warranty of title by the company (*Longman* v. *Bath Electric T. Ltd.*, (1905) 1 *Ch.*. 646). Neither are certificates accompanied by blank

transfer duly signed by the registered owners negotiable instruments (*Roopchand* v. *National Bank of India, Ltd.*, (1919) 46 *Cal.* 342; *Hazarimul* v. *Satish Chandra Bose*, (1919) 46 *Cal.* 331). Share-certificates are goods within the meaning of the Section 76 of the Indian Contract Act, the corresponding Section 2 (7) of the Indian Sale of Goods Act, 1930; (*Maneckji Bharucha* v. *Vadilal Sarabhai*, (1926) 50 *Bom.* 360). The certificate as we have seen is an evidence of *prima facie* title, *i.e.*, of legal title only with the result that a prior equitable interest may defeat that title, as in the case where a trustee of shares transfers them in fraud of the right of beneficiaries, the prior equitable title of the latter would prevail, if in case the notice of this equitable title were to be given to the company before the transfer is effected (*Shropshire Union Ry.* v. *R.*, (1876) *L. R.* 7 *H. L.* 496; *R. D. Sethna* v. *National Bank of India Limited*, (1912) 36 *Bom.* 334; *Ireland* v. *Hart*, (1902) 1 *Ch.* 522). In the *Shropshire Case* the House of Lords have held that the fact that the trustee happened to be in possession of certificates on which he was described as the absolute owner of shares, did not prevent the beneficiaries from setting up their rights as against a *bona fide* mortgagee without notice. This of course would apply as far as the purchaser has not completed his title by getting the shares transferred on his own name because once he has done so, it cannot be affected by equitable rights of which he had no notice when the shares were bought by him (*Guy* v. *Waterloo Bros.*, (1909) 25 *T. L. R.* 515). If the directors issue certificates of shares, or stock, which did not exist they will be personally liable for damages on the footing of having given an implied warranty of authority (*Firbanks Executors* v. *Humphreys*, (1887) 18 *Q. B. D.* 54). The deposit of a certificate without a transfer or memorandum will constitute an equitable mortgage of the shares (*Harold* v. *Plenty*, (1901) 2 *Ch.* 314; *Tahiti Cotton Co., Ex-parte Sargent*, (1874) 17 *Eq.* 273; *London Joint Stock Bank* v. *Simmons*; (1892) *A. C.* 201; *Deverges* v. *Sandeman Clark & Co.*, (1902) 1 *Ch.*

579). In the same way if a owner of shares leaves same in the hands of his broker with a blank transfer and the broker deposits same against an advance of money, the purchaser would be estopped from disputing the validity of the charge (*Fuller* v. *Glyn, Mills, C. & Co.,* (1914) 2 *K. B.* 168).

Where certificates are issued for different classes of shares there are frequent cases where the rights of the holders of different classes are stated which is rather convenient. The receipts issued for allotments, calls, etc., are commonly known as "scripts." These scripts are not share-certificates, but they only indicate that when the share-certificate is ready, the owner would be entitled to exchange these scripts against the share-certificates.

The articles of association of most of the companies contain provisions for the issue of lost certificates, one of which specimen is given below.

With reference to the note which is sometimes inserted in the form of share-certificate at its foot in which it is stated that before the transfer is registered the share-certificate must be produced, it has been held that such a note is only a warning to the shareholder concerned and is not addressed to outsiders, thereby it cannot be argued that it creates a contract or an estoppel against the company on which the outsiders can rely (*Rainford* v. *James Keith & Blackman Co.,* (1905) 2 *Ch.* 147; *Gay* v. *Waterloo Bros.,* (1908) 25 *T. L. R.* 515).

CERTIFICATES OF SHARE-WARRANTS

We have already seen that these share-warrants are negotiable instruments entitling the bearer thereof to shares or stock specified in them which can be transferred by the holder by the delivery of the warrant. (Sec. 44). Thus before a share-warrant is signed, sealed or issued it should be properly stamped with the stamp duty required by law and the other point to be noted is that these share-warrants can only be issued in respect of fully paid shares. In India, as we have already stated, share-warrants,

though permitted by our Act and generally provided for by the articles of many companies, are seldom seen in actual use and even in England this form does not seem to be quite popular. It should also be noted that private companies cannot issue share-warrants, or take power to do so, for the simple reason that thereby the restriction as to the number of persons who are to be the members of the company as required by the Act cannot be observed.

SPECIMEN CLAUSES IN THE ARTICLES AS TO SHARES.

The shares in the capital shall be numbered progressively according to their several denominations, and, except in the manner hereinbefore mentioned, no share shall be sub-divided.

The directors may allot and issue shares in the capital of the company as payment or part payment for any property sold or transferred, goods or machinery supplied, or for services rendered to the company, either in or about the formation or promotion of the company, or the conduct of its business; and any shares which may be so allotted may be issued as fully paid-up shares, and if so issued, shall be deemed to be fully paid-up shares.

An application signed by or on behalf of an applicant for shares in the company, followed by an allotment of any share therein, shall be an acceptance of shares within the meaning of these articles; and every person who thus or otherwise accepts any shares and whose name is on the register, shall, for the purposes of these articles, be a shareholder.

The money (if any) which the directors shall, on the allotment of any shares being made by them, require or direct to be paid by way of deposit, call or otherwise, in respect of any shares allotted by them, shall immediately on the inscription of the name of the allottee in the register of members as the name of the holder of such shares, become a debt due to and recoverable by the company from the allottee thereof, and shall be paid by him accordingly.

Every member, his executors, and administrators shall pay to the company the proportion of the capital represented by his share or shares, which may, for the time being, remain unpaid thereon, in such amounts, at such time or times, and in such manner, as the directors shall, from time to time, in accordance with the company's regulations, require or fix for the payment thereof.

Every member or allottee of shares shall be entitled, without payment, to receive one certificate under the common seal of the company, in such form as the directors shall prescribe or approve,

specifying the share or shares allotted to him and the amount paid thereon; and any two or more joint allottees of a share shall, for the purpose of this article, be treated as a single member, and the certificate of any share which may be the subject of joint ownership may be delivered to any one of such joint owners on behalf of all of them. For any further certificate the directors shall be entitled, but shall not be bound to prescribe a charge not exceeding annas eight.

If a certificate be worn out defaced, destroyed or lost, or if there is no further space on the back thereof for endorsements of transfer, it shall, if requested, be replaced by a new certificate on payment of rupee one, provided however that such new certificate shall not be granted except upon delivery up of the worn out or defaced or used up certificate for the purpose of cancellation, or upon proof of destruction or loss, and such indemnity as the board may require in the case of the certificate having been destroyed or lost. Any renewal certificate shall be marked as such.

If any share stands in the names of two or more persons the person first named in the register shall, as regards receipt of dividends or bonus, or service of notices and all or any other matters connected with the company, except voting at meetings and the transfer of the share, be deemed the sole holder thereof, but the joint holders of a share shall be severally as well as jointly liable for the payment of all instalments and calls due in respect of such share, and for all incidents thereof according to the company's regulations.

In the case of the death of any one or more of the persons named in the register as the joint-holders of any share, the survivor or survivors shall be the only persons recognised by the company as having any title to or interest in such share; but nothing herein contained shall be taken to release the estate of a joint-holder from any liability on shares held by him jointly with any other person.

The company shall not be bound to recognise any equitable, contingent, future or partial interest in any share, or (except only as is by these presents otherwise expressly provided) any other right in respect of a share than an absolute right thereto, in accordance with these presents, in the person from time to time registered as the holder thereof.

No shareholder who shall change his name or place of abode, or who, being a female, shall marry, or the husband of any such last mentioned shareholder, respectively, shall be entitled to recover any dividend or to vote, until notice of the change of name or abode, or marriage, be given to the company, in order that the same be registered.

TRANSMISSION OF SHARES

When a shareholder dies, his share vests in his executor or administrator, as the case may be, and his estate is liable to pay calls in case a balance remains unpaid. These representatives may either allow the shares to be entered on the register in their own names, or allow them to remain on the register in the name of the deceased shareholder.

The executors or administrators must prove their title by producing the probate or letters of administration and thereafter the company must deal with them. The directors cannot compel an executor to get his name entered on the register of members. The usual course for the executors to follow is either to accept liability, or to transfer the shares in favour of a legatee or a purchaser. Even when the executors have not got the shares transferred to their names they are nevertheless entitled to a dividend (*Bombay Burma T. C. Ltd.* v. *F. Y. Smith,* (1894) 19 *Bom.* 1). In the case of a bequest of shares by a deceased shareholder, the bequest carries with it the right to accretion of capital as a result of the capitalisation of the undivided profits (*Buxton* v. *Buxton,* (1930) 1 *Ch. D.* 648).

In the case of bankrupts or insolvents the said shares vest in the official assignee, whereas, in the case of lunatics they vest in the committee, if any, appointed by the Court. The personal representative may, if he likes, transfer his shares, or allow them to remain in his name. In case the shares are kept under their names in the register, they are personally responsible on them, but they are entitled to be indemnified by the beneficiaries in case any loss is sustained. Section 35 of our Act lays down as follows in that regard :—

> A transfer of the share or other interest of a deceased member of a company made by his legal representative shall, although the legal representative is not himself a member, be as valid as if he had been a member, at the time of the execution of the instrument of transfer.

It has been held that the executor, though not on the register of members, can give notice of dissent in case of reconstruction under Sec. 192 of the English Act, the corresponding section of the Indian Act being Sec. 208C old S. 213 (*Llewellyn* v. *Kasintoe Rubber Estates,* (1914) 2 *Ch.* 670).

It should be remembered that when the articles require that the new shares must be offered to the members and the company happens to issue new shares, the estate of the deceased member should not be ignored and the executor or the administrator who may be in power or the trustee, must be sent the option of purchase in the same usual form as to the other shareholders (*James* v. *Buena Ventura Syndicate,* (1896) 1 *Ch.* 456; *New Zealand Gold E. Co.* v. *Peacock,* (1894) 1 *Q. B.* 622). Executors though not on the list of members can give notice of dissent in case of reconstruction under Section 208C old S. 213 (*Llewellyn* v. *Kasintoe Rubber Estates,* (1914) 2 *Ch.* 670).

So long as the executors or the administrators allow the shares to remain in the name of the deceased, they shall not be personally liable for calls even though the company may without their consent place their names upon the register (*Buchan's Case,* (1879) 4 *A. C.* 549). Unless the articles prohibit the representatives allowing the shares to remain in the name of the deceased, they can allow them to remain so over any length of time. The only inconvenience will be that they are not entitled to have notices sent to them or to the registered address of the deceased unless they themselves become members by registering their names (*Allen* v. *Gold Reefs of West Africa,* (1900) 1 *Ch.* 656). Of course the executors can sell or transfer the shares in their representative character to purchasers or heirs or legatees of the deceased, but the fact that they are executors or administrators or trustees cannot be entered on the register, as the same is prohibited by Section 33 of the Indian Companies Act. In case of partly paid shares the company cannot intervene and prevent their distribution among the heirs of the deceased unless a call has

been actually made (*King, Re. Mellor* v. *The South Australian Land Co.,* (1907) 1 *Ch.* 72). Where the holder of a share becomes bankrupt, the company may provide for the estimated value of the liability for future calls (*McMahon, In re. Fuller* v. *McMahon,* (1900) 1 *Ch.* 173). If the executors get the shares transferred in their own name or accept new shares offered to them they shall be personally liable for payment of calls (*Leeds Banking Co., In re, Fearnside and Dean's Case, Dobson's Case,* (1865) *L. R.* 1 *Ch. App.* 231). Subject to the provisions in the articles of association, the trustee has an option either to leave the shares in the name of the bankrupt or take them into his own name; he can also transfer them without first taking them in his own name or he may disclaim them (*Cannock* v. *Rugeley Colliery Co.,* (1885) 28 *Ch. D.* 363; *Wise* v. *Lansdell,* (1921) 1 *Ch.* 420. If he leaves them in the name of the bankrupt, the bankrupts' estate is liable. If, however, the trustee takes them in his own name he can insist upon a " clean " certificate (*W. Key and Son,* (1902) 1 *Ch.* 467). Where the executors get the shares transferred in their own names, they are free to choose the order in which their names are to stand on the register (*Re. Saunders & Co.,* (1908) 1 *Ch.* 415). Such registration will not amount to a transfer and thus an instrument of transfer is not required. In case of partly paid shares however, if the executors were to transfer them to legatees without providing for the payment of calls when made, he may become personally liable to pay the amount of the legacies in satisfaction of calls (*Taylor* v. *Taylor,* (1870) *L. R.* 10 *Eq.* 477). It has been held that the sole survivor co-parcener of a deceased Hindu shareholder is not entitled to be registered in respect of the deceased's shares without production of probate or letters of administration if the company's articles of association require same to be produced (*Bank of Bombay* v. *Ambalal,* (1900) 24 *Bom.* 350; *Piarilal* v. *Muir Mills,* (1919) 41 *All.* 619). Once the executor or administrator distributes the estate after giving

proper notice, as prescribed by Section 360 of the Indian Succession Act, 1925, he is not liable to any person of whose claim the unpaid creditor may follow the assets in the hands of those who receive same, provided he does so within three years from the date of distribution as laid down by Article 43 of the Indian Limitation Act of 1908. The articles of certain companies give power to the personal representatives such as the executor, or the administrator, to vote at meetings on proof of transmission, which articles would be valid (*Marks* v. *Financial News*, (1919) *W. N.* 237). Though in law every executor can act on his own independently of the others, if two or more of them get themselves registered personally as shareholders, they cannot transfer unless they all join (*Barton* v. *North Staffordshire Rail Co.*, (1888) 38 *Ch. D.* 458; *Barton* v. *London & North Western R. Co.*, (1890) 24 *Q. B. D.* 77). If the executors transfer the shares to one of their number that would be *prima facie* regular (*Grundy* v. *Briggs*, (1910) 1 *Ch.* 444). Where a shareholder domiciled abroad dies, the company may not recognise his personal representatives until probate or letters of administration are obtained in England (*Fernandes' Executors' Case*, (1870) 5 *Ch. App.* 314). Of course generally the probate of Foreign Court is accepted by British Courts without further investigation and their own probate issued in lieu thereof, provided the Foreign Courts extend the same courtesy to the probates of the British Courts. In case of insolvency the official assignee is of course at liberty within twelve months of his appointment to disclaim partly paid shares as a part of onerous property, leaving the company to prove the injury, if any, caused by this disclaimer (*In re. West of England Bank*, (1879) 12 *Ch. D.* 288; *re. Hallett*, (1894) *W. N.* 156). If a trustee becomes bankrupt, the shares which were standing in his name, cannot pass to the official assignee on the footing of reputed ownership, or under the order and disposition clause (*Colonial Bank* v. *Whinney*, (1886) 11 *A. C.* 426).

We have seen that the articles entitle directors to refuse the transfer, but such articles shall not apply to the shares of a shareholder who happens to be indebted to the company as against transmission to an executor, administrator or an official assignee or trustee in bankruptcy (*Re. Bentham Mills Spinning Co.*, (1879) 11 *Ch. D.* 900).

In connection with the transmission the secretary should remember that if the transmission has taken place through death of the shareholder, the shares would go to his executor if he has died making a will or testament. In this case the executor appointed in the will would naturally like either the shares to be transferred on his personal name, or to be transferred to one of the legatees as desired by the deceased in his will. Under any circumstance it is the duty of the secretary to call for the probate of the will and satisfy himself that it is the last and the only testament of the deceased and that the executor is the proper person to act as his personal representative. A special book is maintained by joint stock companies in this connection called "the register of probates" in which particulars of probates that may be presented to the secretary at the company's office from time to time are registered for future reference as we shall see under the heading of "register of probates." The articles of association of joint stock companies usually contain rules applying to transmission of shares which are given later. The legal personal representatives or the executor and administrator of the estate of the deceased are not entitled to receive notices unless the articles so provide (*Allen* v. *Gold Reefs of West Africa,* (1900) 1 *Ch.* 656).

LETTER OF REQUEST

When legal personal representatives wish that the shares of the deceased should be registered in their own names as members, they shall do so by a "letter of request." This letter of request is treated in connection with the company procedure in the same manner as

a transfer, the old certificates are then endorsed in favour of these new holders, or better still, the old account of the deceased is closed and entirely new accounts are opened in the register of members relating to the legal personal representative concerned and new certificates issued in their names, against the old certificate received back and cancelled.

The following is the usual form of letter of request used in this connection :—

FORM OF REQUEST FROM EXECUTOR OR ADMINISTRATOR FOR TRANSFERRING SHARES IN THEIR OWN NAMES.

To

The Bombay Trading Co., Ltd.,
Esplanade Road,
Bombay.

No. of Shares.	Distinctive Nos. From. To.	Kind of Shares.
		Re. 1 Ordinary Shares. Re. 1 Cumulative Preference Shares. As. 4 Deferred Ordinary Shares.

Name and Address of Deceased Shareholder as in the Company's Books.	Standing in the name of.................. ....
Name(s) (in full) Address(es) and description(s) of Shareholder(s) as they are to be entered in the Company's Books.	I|We being the Executor(s)|Administrator(s) of the said.........hereby request and authorise you to cause the above-stated Shares to be registered in the Company's Books in my|our name(s) as follows subject to the same conditions as appertained to the holding in the company of the said deceased......... ....

Executor(s) of the Will of..............
Administrator(s) of the estate of..........
.........................deceased.
Dated.....................19...

Witness to the Signature of.............	Signature.
Signature of Witness.....................	
Address................................	
Occupation..............................	....

Witness to the Signature of.............	Signature.
Signature of Witness.....................	
Address................................	....
Occupation..............................	

NOTE :—This form must be signed by all the executors or administrators, and must be lodged at the company's offices, accompanied by the share-certificates and Rs. 2 Registration Fee.

THE REGISTER OF PROBATES

We have already seen that the executor's power is derived from the will and the probate is a sealed copy of the said will, issued by the Court after the same has been proved and comprises an authority for the executor to act on same. On the same basis where there is no will, an administrator is appointed, or where there is a will and no executor is appointed or he refuses to act, an administrator is appointed, and letters of administration are issued by the Court which constitute the authority for the administrator to act. In case of official assignees, or trustees in bankruptcy in England, the order of the Court appointing

them is their authority and in case of lunacy where the lunacy Court after due enquiry appoints a committee or the guardian of the lunatic, there also, the Court's order is the authority of the committee or the guardian. Joint stock companies generally keep a separate book which they call register of probate and administration, in which they record particulars about probates and administration, which might have been produced to them by the parties concerned to prove their authority, for facility of future reference. The registers are to be ruled with columns for date of the exhibition of the document, death of member, the nature of document, names and addresses and description of the executor or the parties authorised together with their powers, names or initials of the officers of the company who have inspected these documents, folio in register of members where the entry as to the shares of the deceased is made, where the shares are transferred in the names of the executors with the letter of request, etc., before returning the order of the Court or probate or letters of administration. The inspecting officer impresses on it a rubber stamp of the company with the word 'registered' or 'exhibited' on it, the date of registration, initials of the registering officer and the number of registration. Of course the executors or administrators or trustees in bankruptcy who are entitled to the shares in their representative character can receive dividends Some articles provide for the personal representative, if he wishes to get this registered, to do so within one year and a day as we have seen above, in absence of any such or similar article, they can allow the shares to stand in the deceased's name on the register as long as they like. Where one of the personal representatives *i.e.*, the executor or administrator, dies, the survivor continues to act and in case of the death of a sole or last surviving executor, the deceased's executors can act for both the estates. But if he dies without a will or without appointing an executor, the administrator of the deceased executor cannot act and letters of administration *de bonic non*, which means 'none

left to administer,' must be taken out by the next of kin of the deceased shareholder.

It should be noted here that the directors have no power to reject an executor's claim to be so registered in place of the testator, in reliance upon the clause in the articles of association which enables them to refuse transfers under other circumstances (*Bentham Mills Spinning Co.*, (1879) 11 *Ch. D.* 900). They cannot even divide the shares into blocks with the names of the holders entered in a different order (*Burns* v. *Siemens Bros. Dynamo Works, No.* 2, (1919) 1 *Ch.* 225).

In case where the transmission is in bankruptcy or insolvency, the trustee in bankruptcy in England and the official receiver in India, may disclaim unpaid shares under powers given to them under the Indian Presidency Towns Insolvency Act 1909; otherwise if the shares are fully paid, they vest in these officers who can sell them for the benefit of the estate.

MODEL ARTICLES ON TRANSMISSION

The following is the usual clause in the articles of association of Indian Companies in connection with transmission on death or bankruptcy :—

The executors or administrators of a deceased member (not being one of several joint-holders) shall be the only persons recognised by the company as having any title to the shares registered in the name of such member and in case of death of any or more of the joint-holders of any registered shares the survivors shall be the only persons recognised by the company as having any title to or interest in such shares. Provided that if the member should have been a member of a joint Hindu family, the directors on being satisfied to that effect and on being satisfied that the shares standing in his name in fact belonged to the joint family, may recognise the survivors thereof as having title to the shares registered in the name of such member. The company shall not be bound to recognise an executor or administrator unless he shall have obtained probate or letters of administration, or other legal representation as the case may be from a duly constituted Court in British India or from a local authority authorised by an Act of the Legislative Council

of India or by any order or notification of the Governor-General in Council, provided nevertheless that it shall be lawful for the directors to dispense with the production of probate or letters of administration or such other legal representation upon such terms as to indemnity or otherwise as to the directors may seem just.

Any person becoming entitled to shares in consequence of death or bankruptcy of any member upon producing such evidence that he sustains the character in respect of which he proposes to act under this clause or of his title as the directors think sufficient, may, with the consent of the directors (which they shall not be under any obligation to give) be registered as a member in respect of such shares, or may, subject to the regulations as to transfers herein before contained transfer such shares.

FORMS OF ARTICLES IN CONNECTION WITH TRANSFER OF SHARES OF PUBLIC COMPANIES

The usual articles in connection with transfer of shares of a public company are made out in the following form in addition to the articles which we have already considered in connection with the restriction on the shares, right of transfer and powers of the directors to refuse transfer.

Register of Transfer. The Company shall keep a book, to be called the "register of transfers" and therein shall be fairly and distinctly entered the particulars of every transfer or transmission of any share.

Form of Transfer. Shares in the company shall be transferred by an instrument in writing in such form as shall from time to time have been approved by the directors, and, until any other form shall have been so approved, in the form following, or as near thereto as circumstances will, admit :—

THE X. Y. AND Z. COMPANY, LIMITED.

I................. of..................in consideration of the sum of Rupees......... ....paid to me by.................of ....(hereinafter called "the Transferee") do hereby transfer to the transferee the.........share numbered...... ......standing in my name in the books of THE X. Y. & Z., COMPANY, LIMITED to

hold unto the transferee his executors, administrators and assigns, subject to the several conditions on which I hold the same at the time of the execution hereof and I the transferee do hereby agree to take the said shares subject to the same conditions.

As witness our hands the.............day of...........19 . Witness

To be executed by Transferor and Transferee.

Every such instrument of transfer shall be executed by the transferor and transferee, and the transferor shall be deemed to remain the holder of such share until the name of the transferee is entered in the register of shareholders in respect thereof.

Transfer books when closed.

The directors shall have power to close the transfer books at such time or times and for such period or periods, not exceeding in the aggregate thirty days in each year, as to them may seem expedient.

Notice of intended sale to be given to Board.

Any shareholder intending to dispose of his share or shares in the company to any person whomsoever, shall in the first instance send to the agents a printed or written notice stating what share or shares the shareholder is desirous of disposing of, the name, address and description of the person or persons proposing to purchase the same, and the amount actually and *bona fide* offered for the purchase. Provided that the board may in their discretion waive compliance with this article either wholly or in any particular case or cases.

Title to share of deceased holder.

The executor or administrator of a deceased shareholder (whether European, Hindu, Mahomedan, Parsi, or otherwise not being one of two or more joint-holders) shall be the only person recognised by the company as having any title to his shares and the company shall not be bound to recognise such executor or administrator unless such executor or administrator shall have first obtained probate or letters of administration, as the case may be, from a duly constituted Court in British India, provided that in any case where the board in their absolute discretion think fit,

the board may dispense with production of probate or letters of administration, and, under the next Article register the name of any person who claims to be absolutely entitled to the shares standing in the name of a deceased shareholder as a shareholder.

Registration of persons entitled to shares otherwise than by transfer.

Subject to the provisions of article No.— any person becoming interested in a share in consequence of the death, bankruptcy or insolvency of any shareholder, or the marriage of any female shareholder, or by any lawful means other than by a transfer in accordance with these presents, may, upon producing such evidence as the board think sufficient, either be registered himself as the holder of the share or elect to have some person nominated by him and approved by the board, registered as such holder.

Transfer by person to his nominee.

Provided, nevertheless, that if such person shall elect to have his nominee registered, he shall testify the election by executing to his nominee an instrument of transfer of the share in accordance with the provisions herein contained, and, until he do so, he shall not be freed from any liability in respect of the shares.

Transfer to be presented with evidence of title.

The instrument of transfer shall be presented to the company, duly stamped, together with such evidence as the directors may require to prove the title of the transferor, and generally under and subject to such conditions and regulations as the directors shall from time to time prescribe; and every registered instrument of transfer shall remain permanently in the custody of the company.

Partly paid shares presented by transferor.

In case where the application for registration of the transfer of shares is made by the transferor, no registration shall in the case of partly paid shares be effected unless the company gives notice of the application through the transferee and unless objection is made by the transferee within two weeks from the date of receipt of the notice, the name of the said transferee shall be entered on the register in the same manner and subject to

the same conditions as if the application for registration was made by the transferee. For the purpose of the above article, notice to the transferee shall be deemed to have been duly given if despatched by pre-paid post to the transferee at the address given in the instrument of transfer and shall be deemed to have been delivered in the ordinary course of post.

Where it is proved to the satisfaction of the directors of the company that an instrument of transfer signed by the transferor and transferee has been lost, the company may if the directors think fit on application in writing made by the transferee and bearing the stamp required by an instrument of transfer, register the transfer on such terms as to indemnity as the directors may think fit.

Transfer to be returned after refusal.

If the directors refuse to register a transfer of any shares, they shall within two months after the date on which the transfer was lodged with the company send to the transferee and the transferor notice of the refusal.

NOTE :—The above two articles are suggested in view of the alteration in law caused through the substitution of a new section in place of the old Sec. 34 of the old Act by the Indian Companies Act, 1936. The new Table A, Regulation 20 has also been altered or amended in this regard on the above footing to which the draftsman's attention is invited.

Conditions of registration of transfer.

Previously to the registration of a transfer, the transferee shall produce for the inspection of the agents, the certificate or certificates of the share or shares to be transferred.

Board may registration of transmission.

Every transmission of a share shall be verified in such manner as the directors may require, and the company may refuse to register any such transmission until the same be so verified, or until or unless an indemnity be given to the company with regard to such registration which the board at their discretion shall consider sufficient; provided nevertheless, that there shall not be any obligation on the company or the board to accept any indemnity.

Fee of transfer or transmission. There shall be paid to the company, in respect of the transfer or transmission of any number of shares to the same party, the sum of annas four per share, subject to such maximum on any one transfer as shall from time to time be determined by the Directors.

The Company not liable for disregard of a notice prohibiting registration of a transfer. The company shall incur no liability or responsibility whatever in consequence of their registering or giving effect to any transfer of shares made, or purporting to be made by any apparent legal owner thereof (as shown or appearing in the registering of members) as to the prejudice of persons having or claiming any equitable right, title, or interest to or in the same shares, notwithstanding that the company may have had notice of such suitable right, title or interest or notice.

It will be seen that the above articles prescribe the form in which the transfer is to be effected and such forms are available at the company's office. Unless this form is used the directors may refuse to register them. It is quite open to them to waive the objection. The above articles also require that the transfer form shall be executed both by the transferor and transferee which is quite natural because here unless the transferee agrees to be a shareholder, he cannot be placed on the register. It must also be noted that the transfer form is to be properly stamped and the secretary must refuse to receive same unless it is so stamped. But if a transferee is put on the register his title cannot be impeached subsequently on the ground that it was not so properly stamped (*Indo-China Steam Navigation Co.,* (1917) 2 *Ch.* 100). When the articles provided that "the directors may decline to register any transfer" on certain grounds "and the directors shall not be bound to specify the grounds upon which the registration of any transfer is declined" interrogatories cannot be administered to the directors to ascertain the grounds upon which they refused to register a transfer (*Berry & Another* v. *Tottenham Holspur Football Co., Ltd.*,

(1935) *W. N.* 155). Where the transfer is effected by way of a gift as from a husband to his wife or from a father to his child without any money actually passing, nominal consideration must be inserted and the instrument stamped accordingly.

Resolution as to transfer when the transfer forms are duly accepted by the Board of Directors

Resolution of transfer is more or less in the following form :—

> "Resolved that Transfer Forms Nos. 145, 179 and 180 representing a total number of 275 shares be approved and that the preparation and sealing of new certificates for these shares in the respective names of the transferees as indicated by the said transfers be and is hereby authorised and approved. The old certificates representing the said shares are hereby ordered to be cancelled."

Transfer to a Firm

The transfer may be to a firm in its firm name and if accepted the partners become individually liable for calls. The usual and proper course, however, is to require the names of members to be entered in the register as joint holders.

Stamps on Transfer and Gifts of Shares

It should be also seen that every transfer is properly stamped before it is passed but in case the improperly stamped transfer is passed and transferee put on the register a subsequent objection will not affect the transferee's title. If, however, the transfer is made by mistake and a wrong person placed on the register this may be rectified. The person who transfers his shares remains liable until there is on the register a transferee who is legally liable to the company (*Sorabji Jamsetji* v. *Ishwardas Jugjiwandas*, (1896) 20 *Bom.* 654). See also Sec. 156. When the transfer is complete and the transferee entered on the register he becomes liable to pay all money falling due after this event on his shares. When shares

are given by way of a gift, the gift is complete only after the transfer deed is accepted and registered on the company's books (*Amarendra Krishna Dutt* v. *Moni-munjari*, (1921) 48 *Cal.* 986).

LOST SHARE CERTIFICATE

When a share certificate is lost the shareholder applies for a new share certificate being issued in which case generally the company insists upon a indemnity letter being given to it, at the same time many companies advertise the loss in the papers at the expense of the shareholder concerned. The letter of indemnity taken from the shareholder is more or less in the following form :—

Bombay, 16th January, 1936,

To

The Secretary,

Bombay Trading Co., Ltd., Bombay.

Dear Sir,

A share certificate No. 7562 for 50 ordinary shares of Rs. 500 each numbered 75—124 inclusive in your company has been lost, misplaced or destroyed and I hereby request you to issue to me a new certificate for the said shares in consideration whereof I undertake to indemnify you and save you harmless against any losses, costs, damages, charges and expenses which you may incur in consequence or by reason of the said certificates being lost, mislaid or destroyed or by reason in consequence of the issue by your company to me of a new certificate in respect of the said

I hereby further declare that I have not sold, pledged or otherwise disposed of my interests in the said shares.

Yours faithfully,

X. Y. Z.

Witness to signature A. B. C.

NOTICE OF TRANSFER OR LODGING OF TRANSFER

Application by Transferee

It is usual though not compulsory to send the transferor a letter where the transfer has been lodged by the transferee

for registration, from the secretarial department or from the register's office of the company concerned where there is a special registrar looking after the share registration and share transfer, as is the case with large companies where this work is being specially assigned to a special officer. The notice will be in more or less the following form :—

Bombay Trading Co., Ltd., Bombay.
Bombay, 15th January, 1937.

Jagjiwan Umaidwar, Esq.,
Bombay.

Dear Sir,

Re. Transfer Form No. 765.
Notice of Transfer of Shares.

I have to inform you that a transfer form purporting to be signed by you and made out in favour of Mr. Jamnadas Gordhandas as the transferee for 10 ordinary shares Nos. 75—84 has been lodged this day in this office for registration and unless I hear from you to the contrary within 48 hours from your receipt of this letter, the said transfer will be taken up to be in order and brought forward for consideration at the next meeting of the board of directors and if approved will be duly registered.

Yours faithfully,
(Sd.) W. Pestonji,
Secretary.

APPLICATION BY TRANSFEROR

Where however the application for transfer (1) is lodged by the transferor and (2) the shares are partly paid Sec. 34 now requires that registration must not be made of these partly paid shares unless the company gives notice of the application to the transferee. This notice will be in the following form :—

Bombay Trading Co., Ltd., Bombay.
Bombay, 15th January, 1937.

Jagjiwan Umaidwar, Esq.,
Bombay.

Dear Sir,

Re. Transfer Form No. 765.
Notice of Transfer of Shares.

I have to inform you that a transfer form purporting to be assigned by you as a transferee of which Mr. Jamnadas Gordhandas

happens to be the transferor for ten ordinary shares Nos. 75-84 respectively has been lodged this day in this office for registration and I give you this notice in connection thereof as required by Sec. 34 of the Indian Companies Act, 1913 amended up to 1936 of the said transfer having been lodged in this office by the transferor, the said Mr. Jamnadas Gordhandas. I have also to request you to let me have any objection if any to my proceeding with the said transfer within two weeks from the date of receipt of this notice, failing which the said transfer will be taken up to be in order and brought forward for consideration at the next meeting of the board of directors and if approved will be duly registered.

Yours faithfully,

(Sd.) W. Pestonji,

Secretary.

EXAMINATION AND PASSING OF TRANSFER

The transfer forms after they are lodged must be carefully examined with a view to see that they are properly filled in and signed and that they bear the name and address of the broker concerned. It is also to be seen whether transfer is either certified or is accompanied by the relevant share certificate and that they are properly stamped. All alterations should be initialled by the parties concerned and the numbers of shares and their denominations should be correctly entered. As soon as this is done a rubber stamp is affixed, giving the date on which the said transfer is lodged and the number of transfer receipt or the balance ticket issued. After having sent the usual advice to the transferor or the transferee as the case may be as to the lodgment of the transfer, the matter may be brought before the transfer committee of the board of directors as early as convenient. If the transfer is refused to be registered by the directors they must within two months after the date on which the transfer was lodged with the company send to the transferee and the transferor notice of the refusal [S. 34 (4)]. If the transfer is passed it is usual practice to issue a temporary certificate which is to be exchanged for a regular share certificate. This is to be

done of course after giving sufficient time to the transferor to reply to the notice of the lodgment of the transfer. If the same has been sent out when the transfers are passed each of them is initialled by the chairman at the appropriate place on the form. When there are a large number of transfers a list is to be prepared beforehand and if they are all passed the chairman signs same. In case the transferee is a corporation or a joint stock company, the company should be called upon to produce its memorandum and articles of association with a view to ascertain whether the constitution of the company empowers it to hold shares in another company (*Bath's Case,* (1878) 8 *Ch. D.* 334). In case the transfer form is signed by an agent, the power of attorney or any other authority in writing which he may hold are to be called for and examined carefully. If the transferee is a joint stock company, it should be carefully noticed whether the transfer form bears the seal of the company and articles of association of the said company should be looked into with a view to see whether there is any clause on this particular. The secretary of the company concerned should also be asked to produce a copy of the resolution of the board of directors authorising the sealing of such a transfer duly signed by the chairman of the meeting. It is also to be seen that the transfer is not made to an infant for reasons which we have already discussed in connection with holding of shares by minors. In case of a partnership the transfer can only be made to the members as joint holders and not as a firm. If the transfer is made to or by an illiterate there should be attestation clause to the effect that the said transfer was read and explained to the illiterate which should be witnessed by at least two responsible witnesses. In the case of a transfer signed or executed outside the United Kingdom the same should be attested by the British Consul in that location, or a Justice of the Peace, or other responsible official. In the case of joint holders the transfers must be signed by all the joint holders unless one of them has the authority to sign on behalf of himself

and other joint holders which authority should be called for and inspected. We have already seen above that *in case of an application by a transferor of partly paid shares the company must give notice of the application to the transferee and in case no objection is received from the transferee within two weeks of the date of the receipt the transfer may be registered* [S. 34 (1)]. In case there are calls in arrears on any of the shares sought to be transferred, no doubt the transferee will be liable to pay the calls which are already made, but some companies refuse to give effect to such transfers unless the shares are fully paid. A person who executes a transfer of shares in a company remains liable unless and until there is on the register a transferee who is legally liable to the company until the transferee's name is entered in the register the dividends on the shares are also payable to the transferor for he is deemed to be the holder of the shares until the transfer is made (*In Re. the Peninsular Life A Co., Ltd.*, (1935) 37 *Bom. L. R.* 904). It should also be seen whether the company has got a lien on the shares sought to be transferred. The right of the company in connection with the lien on their shares against the holder of the shares for debt due by him to the company as reserved in the articles, have already been dealt with in this book elsewhere.

NOTICE IN LIEU OF DISTRINGAS

Frequently notices are lodged by a third party, warning the company against transfer of certain shares without informing the giver of the notice as the latter claims some right or charge on these shares. This notice is given by a person who has an equitable claim to the shares with a view to prevent his claim from being prejudiced by the registered holders of the shares dealing with same in any way. This notice can also be given with a view to prevent even the dividend being paid on such shares without notice being given to the person serving this notice. The procedure is that the claimant interested

in shares or dividends, files an affidavit in the prescribed form made by himself or by his solicitors, in which he discloses the nature of his interest and the material facts of his case, at the proper Court having jurisdiction in this matter, which affidavit is accompanied by a notice in the prescribed form. He then procures an office copy of the said affidavit and an authentic duplicate of the notice filed as above and serves same on the company. This notice usually asks the company to refrain from registering the transfer of the share or from paying dividend on same to the registered holder without in the first instance notifying the claimant of such proposed registration of transfer or payment of dividend. The company which receives this affidavit is now bound to take a note of the fact, though in the case of application for registration of transfer, or for receipt of dividend when declared, the claimant is notified in the first instance of the fact, the claimant should thereupon take action with a view to prevent the transfer by obtaining an order or injunction of the Court in that connection within eight days, failing which the distringas ceases to operate and the company must proceed to register the transfer or pay the dividend as the case may be (*Blaksley Trusts*, (1883) 23 *Ch. D.* 549; *Hobbs* v. *Wayet*, (1887) 36 *Ch. D.* 256). If the party wishes to withdraw the distringas he can do so by notice to the company which must be sent by the claimant and witnessed. This distringas notice is frequently termed " stock notice " or " stock order."

REGISTER OF TRANSFERS

The transfer is then registered in a special book kept for the purpose which is known as the " register of transfers " or " transfer register." Various forms in connection with this transfer register are in use. But the form given is the usual form adopted in practice as being most suitable :—

TRANSFER REGISTER

Number of Transfer	Date of Transfer Lodged	Date of Transfer Deed	Transferor's			Transferor's Folio in Share Register	Shares Transferred					Transferee's			Transferee's Folio in Share Register	Number of New Certificate
			Name	Address	Occupation		Number	Amount per Share paid	Capital paid up	Distinctive Numbers		Name	Address	Occupation		
										From	To					

CALL ON SHARES

The usual practice in the case of joint stock companies whose capital is divided into shares is that a certain amount, not less than 5% of the face value of the shares in the case of a public offer, is payable on application and a certain amount is payable on allotment. The balance is generally recovered through the medium of calls made by the directors from time to time, as and when they require money for the purpose of the company. It is no doubt usually the practice to state clearly in the prospectus the amount of call which is to be made at one time, and sometimes a period is also laid down, which is to intervene before a call, subsequent to the one made, can be made. When payments are to be made in terms of the prospectus, these payments are not calls and thus do not give the special remedies of forfeiture and interest unless the articles of association so provide (*Crosskey* v. *Bank of Wales*, (1863) 4 *Giff*. 314). The memorandum or the articles of association also frequently lay down this fact. In the absence of these provisions a shareholder may be called upon by the directors at their pleasure to pay the call. The call, in the absence of an agreement to the contrary, may be of any amount, and if there is no provision of the type we have referred to above, there is nothing to prevent the directors from calling up the whole amount in one call. If, however, the articles or memorandum, specify a method by which the call has to be made, then that method must be strictly followed, as otherwise, a call might be declared to be invalid (*Pioneer Alkali Works Ltd.* v. *Amiruddin Salebhoy Tyabji*, (1926) 28 *Bom. L. R.* 411). When a call is made the resolution making the call must also fix the date of payment otherwise the call will not be valid (*Cawley & Co.*, (1889) 42 *Ch. D.* 209). In *Pioneer Alkali Works Ltd.* v. *Amiruddin Salebhoy Tyabji*, (1926) 28 *Bom. L. R.* 411, it was held that when articles of association empower the directors to make calls and appoint the amount, time, place and person to whom same is to be paid, the said call can only be made by a resolution

stating the amount, time, place and person and in the case of failure to do so, the defect cannot be remedied by a notice. It has also been held that even if the articles and the memorandum do not provide for a method of making a call, the directors cannot make a call on some members of one particular class and leave off other members of the same class. Again, the powers of directors to make calls is in the nature of a trust which should be exercised for the general benefit of the company. From this it follows that in case the directors make calls for their own advantage they may be prevented by an injunction (*Gilbert's Case,* (1870), 5 *Ch.* 559); and this injunction may be applied for with a view to prevent the directors from enforcing the call by forfeiture, pending trial of the question. The Court usually grants this injunction on terms that the amount of calls may be paid into Court (*Lamb* v. *Sambas Rubber Co.,* (1908) 1 *Ch.* 845). Though of course as far as possible the Court is reluctant to interfere in this matter where a good amount of discretion is allowed to the directors (*Odessa Tramways Co.,* v. *Mendel,* (1878) 8 *Ch. D.* 235). It was laid down in *Alexander* v. *Automatic Telephone Co.,* (1900) 2 *Ch.* 56, to the effect, that the subscribers of the memorandum of a company limited by shares, are not, in the absence of provision in the articles, or any other agreement to the contrary, to pay any calls which are not made in accordance with the articles, or the agreement concerned and the calls must be made in accordance with the articles or the agreement, as the case may be before these subscribers can be called upon to pay. It was also held here that, where the directors by the said agreement with some of the shareholders issue shares and make it incumbent upon these applicants for shares to make payment on application and allotment, whereas, on their own shares for which they have subscribed in the memorandum they do not require payment, and further, where this fact was not disclosed to other shareholders, the directors were held to be guilty of a breach of duty and were made to pay up the amount on their

own shares on the same basis. In other words they were not allowed to benefit themselves at the expense of their shareholders. There is no debt due by the shareholder until the call is made and thus a lien cannot operate in absence of such a call (*Russian Spratt's Patent, Ltd.,* (1898) 2 *Ch.* 149). *In Syke's Case,* (1872) 13 *Eq.* 255, the directors, in the case of a company which was short of money paid in their unpaid amount on the shares they held and out of the money so collected, paid themselves out for fees due to them. Here it was held that the transaction, in effect, was not a *bona fide* payment, as it was effected mainly with the view to serve their own private ends and interests. In the course of the judgment, Sir James Bacon, V. C. said : "I think this transaction cannot be reconciled with those principles which are no doubt universal. In my opinion that was a contrivance by which the directors seem to pay, but did not in fact pay the amount of their shares uncalled for, and therefore the transaction cannot be allowed to stand." As a rule, calls must be paid for in cash but a shareholder who has rendered some services and has a claim for that to be paid by the company, will have the right of set-off (*Laorocque* v. *Beauchemin,* (1897) *A. C.* 353). In this case Lord MacNaghton in the course of his judgment referred to the decision in *Spargo's Case,* (1873) *L. R.* 8 *Ch. App.* 407, where James, L. J. made the following observations which, according to his Lordship, were not inapplicable to the facts of the present case *viz.*: "If a transaction resulted in this, that there was on the one side a *bona fide* debt payable in money at once for the purchase of the property, and on the other side a *bona fide* liability to pay money at once on shares, so that if bank notes had been handed from one side of the table to the other in payment of calls they might legitimately have been handed back in payment for the property, it did appear to me in *Fothergill's Case,* (1873) *L. R.* 8 *Ch.* 270, and does appear to me now, that this Act of Parliament did not make it necessary that the formality should be gone through of the money

being handed over and taken back again; but that if the two demands are set off against each other, the shares have been paid for in cash." Where calls are made during the course of sale of shares there arises out of the contract of sale an implied promise by the purchaser to indemnify his vendor against all calls that may be made upon him in respect of the shares at any future date, whether made while the purchaser remains entitled to the shares or after he has parted with them to a sub-purchaser and it makes no difference in that respect that the transfer which the vendor delivers to the purchaser in completion of his contract is executed in blank (*Spencer* v. *Ashworth Partington and Co.,* (1925) 1 *K. B.* 589). As we have seen under the heading of "Articles as to Forfeiture" that when shares are forfeited for non-payment of calls and the articles lay down that in spite of forfeiture the shareholder is bound to pay the calls made, and if these shares are re-allotted to another person such other person is entitled in winding up to be credited for all sums paid by the prior holder, whether so paid as a shareholder or as a debtor with regard to his liability in the terms of the articles (*In Re. Randt Gold Mining Co.* (1904) 2 *Ch.* 468). In another case where under similar circumstances the forfeited shares were re-allotted to other persons with the result of a loss to the company and whether the original shareholder whose shares were forfeited became a bankrupt subsequently, it was held that the company was entitled to prove for the actual loss suffered, *viz.*, the difference between the amount received on the re-allotment of forfeited shares and the amount due on the date of the forfeiture. (*In re. Bolton Ex-parte, North British Artificial Silk, Ltd.,* (1930) 2 *Ch.* 48). Here it was further laid down that any payment of the uncalled capital by the new allottees must ensure for the benefit of the original allottee whose shares were forfeited and thus release him *pro tanto* in respect of the damages for which his breach of contract in failing to pay the calls rendered him liable. The directors who do not take the necessary steps to compel every

shareholder to pay the calls made are guilty of breach of duty (*Spakmacn* v. *Evans*, (1868) *L. R.* 3 *H. L.* 171). The calls in arrear may be subject to payment of interest if the articles so provide. The Table "A," clause 14 provides that in case a call is not paid on or before the date on which it is made payable, interest upon the sum due shall be chargeable at 5 per cent. per annum from the date appointed for the payment thereof to the actual time of payment. Of course special articles of a company may provide otherwise, and if necessary, provide for a higher rate of interest. In the same manner the company can by its articles provide for a payment in advance of the calls not yet made and may also arrange to pay interest on such a sum. This interest, in such a case, may be paid even though there are no profits. In the case in which this point was decided, a call received in advance from the shareholder was treated as if it was a loan made to the company and the member who advanced this became the creditor of the company. *Lord Herschell* in the course of his judgment expressed himself as follows :—

"It is a fallacy to speak of this payment of interest as being a payment made to a member in his character of member. As member he has no right to have that interest paid to him; he could not claim it. As a member he was under no obligation to make the payments in consideration of which the company undertook to pay interest. When, therefore, the company, although they received the money from a member, received it from him without any obligation upon him as a member to pay it, and undertook to make a payment to him in consideration of it, which they were not under any obligation to make to him as a member, it seems to me that it is manifestly erroneous to describe this as a payment made to a member in his character of member" (*Lock* v. *Queensland Investment Co.,* (1896) *A. C.* 461). The Table "A," clause 17, provides for the payment of interest on calls paid in advance at the rate of 6 per cent. There is, however, no advantage gained by paying such calls in advance as

far as a shareholder is concerned, except that he may get a certain rate of interest, because in case the company goes into liquidation, the amount so paid in advance shall not be returnable except after the payment of costs of winding up and the payment in full of the ordinary creditors (*Wakefield Rolling Stock Co.*, (1892) 3 *Ch.* 165; *Exchange Drapery Co.*, (1888) 38 *Ch. D.* 171). These calls once paid in are not repayable as long as the company is a going concern and before it goes into liquidation (*London and Northern Steamship Co.* v. *Farmer*, (1914) *W. N.* 200). In case where the shares are transferred, and a call is made before the transfer, but which is payable after the transfer, remains unpaid, the transferor remains liable to pay the call to the company, but he is entitled to be indemnified by the transferee for this amount (*National Bank of Wales. In re. Taylor, Phillips and Rickard's Cases,* (1897) 1 *Ch.* 298). When a member dies after a call is made the amount is payable out of his estate and the same result follows if the call is made after his death should his name remain on the register of members (*New Zealand Gold Extraction Co.* v. *Peacock,* (1894) 1 *Q. B.* 622). When a shareholder becomes insolvent the company can not only prove for calls already made but also for the balances uncalled on the insolvents shares (*Re. McMahon, Fuller* v. *McMahon,* (1900) 1 *Ch.* 143). In case of calls in arrear, when a member transfers his shares he does not transfer liabilities in respect of calls already made, but he transfers only his liabilities to future calls. This is because the transfer of share amounts to a transfer of all the shareholders' rights and obligations as from the date of the transfer and obligations incurred prior to such a transfer (*In re. National Bank of Wales, Taylor, Phillipe and Ricard's Cases,* (1897) 1 *Ch.* 298).

When the trustees get themselves registered as shareholders, they are personally liable to the company for calls and not the *cestui qui trust* (*In Re. Cree, Liquidator of Bomington S. R. Co.* v. *Somervail,* (1879) 4 *A. C.* 648). But the trustee is entitled to be indemnified by the beneficial

owner against these calls (*Hardoon* v. *Belilios,* (1901) *A. C.* 118). A transferee of shares by way of mortgage is liable as a contributory as he stands in the same position as a trustee. In winding up, however, Sec. 156 creates a new liability for shareholders in respect of unpaid calls which can be recovered though barred by limitation. This applies to all kinds of winding up (*Sorabji Jamsetji* v. *Ishwardas,* (1896) 20 *Bom.* 654; See also *Vaidiswara Ayyar* v. *Siva S. Mudaliar,* (1907) 31 *Mad.* 66 and *Habib Rowji* v. *Standard Aluminium and Brass Works Ltd.,* (1925) 27 *Bom. L. R.* 574 *at p.* 579). A contract for the payment of calls by instalments is determined on winding up and the liquidator can call the whole amount unpaid.

Where shares are payable in instalments the prospectus, or the application form which accompanies the prospectus, usually contains a statement or agreement to that effect. Sometimes the application form refers to the arrangement as mentioned in the prospectus in connection with paying of the cash due on shares by calls or instalments. This agreement, of course, is operative so long as the company is a going concern, but as soon as it goes into liquidation, all instalments become due and may be called up immediately (*Cordova Union Gold Co.,* (1891) 2 *Ch.* 580; *Re. Pyle Works, in re.* (No. 1), (1890) 44 *Ch. D.* 534 *per Lindley, L. J. p.* 583). Frequently the articles of association mention these clauses or instalments by stating that not more than a certain amount can be called up at a time and also lay down the interval which must lapse between one call and another. Even when a call is made by the directors whose appointment was defective, provided the defect was unknown at the time they made the call, the call would be valid irrespective of the fact whether the articles contain a validating clause or not (*Dawson* v. *African Consolidated Company,* (1898) 1 *Ch.* 6; *Briton Medical & G. L. Association* v. *Jones,* (1889) 61 *L. T.* 384). This principle is reiterated now in Sec. 86 of the Indian Companies Act, 1913 as follows :—

"The acts of a director shall be valid notwithstanding any defect that may afterwards be discovered in his appointment or qualification : Provided that nothing in this section shall be deemed to give validity to acts done by a director after the appointment of such director has been shown to be invalid."

Where the number of directors falls below the minimum number specified by the Act, or that specified by the articles, no call can be made unless there is a clause in the articles, as is usually inserted, which authorises the the continuing directors to act, but in that case also the requisite quorum must be present (*Bottomley's Case*, (1881) 16 *Ch. D.* 681; *York Tramways Company* v. *Willows*, (1882) 8 *Q. B. D.* 685). In law the call becomes a debt from the date when it is made, even in spite of the fact that it is made payable at a future date, and that too, whether there is, or not, an article providing that the call shall be deemed to have been made at the date of the resolution of the directors (*Dawes' Case*, (1869) 38 *L. J. Ch.* 512; *R.* v. *Londonderry*, 18 *L. J. Q. B.* 343). If a person held a number of shares he cannot require the company to accept the payment in respect of some only of such shares, for the simple reason that his liability is one and indivisible. In case of subscribers to the memorandum it is now possible to arrange to pay for the shares for which they subscribed in consideration other than cash, but this fact must be quite clear either from the memorandum, or the articles, or the prospectus, or the agreement under which the shares are issued as fully-paid, that that was the intention of the parties when such agreement was made and that the shares for which these subscribers signed the memorandum were to be a part of those that were agreed to be allotted to them as such fully-paid shares. This rule would also apply to shares in respect of which a person appointed director has, under Sec. 84 of the Indian Companies Act of 1913, of a company by the articles, to sign and file with the registrar a consent in writing both to act as such director and to take up and pay for a number of shares not less than his qualification,

or to a contract signed and filed by him with the agreement to take from the company and pay for his qualification shares (*Drummond's Case*, (1869) 4 *Ch.* 772). The articles frequently provide that persons who have not paid all calls or other sums presently payable in respect of their shares, shall not be entitled to vote. In drafting an article of this character, care has to be taken to make the intention quite clear, otherwise the purchaser of forfeited shares may be incapacitated to vote due to the default of his predecessor (*Randt Gold Mining Company* v. *Wainwright*, (1901) 1 *Ch.* 184).

It has also been held that the power to make calls is in nature of a trust and must be exercised strictly in the interest of the company in general (*In re. Gilbert's Case*, (1870) 5 *C. A.* 559; *Alexander* v. *Automatic Telephone Co.*, (1900) 2 *Ch.* 56), and thus it follows that if the directors make calls for their own purposes it will be an abuse of their power and they can be restrained by an injunction (*Norman* v. *Mitchell*, (1854) 19 *Beav.* 278). Of course the shareholder while bringing such an application for injunction must prove the *mala fides* (*Odessa Tramways Co.* v. *Mendel*, (1878) 8 *Ch. D.* 235).

Except on very special grounds, calls will not be allowed to be made to a certain number of shareholders of the same class, leaving off the others, because as a general rule, the call should be made *pari passu* (*Galloway* v. *Halle Concerts Society*, (1915) 2 *Ch.* 233). If the directors make calls on shares of other shareholders, but do not do so with respect of their shares, they would be guilty of misfeasance (*Alexander* v. *Automatic Telephone Co.*, (1900) 2 *Ch.* 56). Even where Articles do not specify the payment of calls in arrear the directors may make them so payable (*Ambergate E. J. Rail Co.* v. *Norcliffe*, (1851) 6 *Exch. R.* 629).

Payment of Calls in Advance

Frequently articles of association provide that calls may be paid in advance, in case the shareholder so desires,

and in such cases of payment on shares in addition to the called up amount, though no dividend is payable, interest at an agreed rate is allowed. Here it has been held that this power has to be exercised in the interests of the company as it is in nature of a trust, with the result that directors should not receive money in advance, unless they are sure that it is required for the benefit of the company. When they so receive these calls in advance, the interest should not be excessive (*Poole, Jackson and Whyte's Cases,* (1878) 9 *Ch. D.* 322; *In Re. Pyle Works,* (1890) 44 *Ch. D.* 534). Where the directors paid up the remaining amounts on their shares in advance and utilised the money for their own fees in case of an insolvent company the transaction was held to be not *bona fide* and ineffectual and therefore the directors remained liable on their shares (*Syke's Case,* (1872) *L. R.* 13 *Eq.* 255; *Washington Diamond Mining Co., Re.,* (1893) 3 *Ch.* 95; *Mason's Case, In Re. Liverpool Land G. & A. Insurance Co.,* (1882) 30 *W. R.* 378).

When the shareholder pays the calls in advance, it is virtually the amount borrowed by the company on interest, and thus, the interest on the advance amount constitutes a debt due by the company which must be paid whether there are profits or not and whether dividends are declared on the paid up amount of the said shares or not (*Lock v. Queensland Investment & Land Mortgage Co.,* (1896) *A. C.* 461) neither can the shareholder claim the repayment of capital so paid in advance at any time of the existence of the company or prior to liquidation (*Lock* v. *Queensland Investment & Land Mortgage Co., cited above and London & Northern Steamship Co.* v. *Farmer,* (1914) *W. N.* 200). The drawback of paying the calls in advance is that such shares are not generally saleable with the amounts paid in advance in calculation on the exchange and the money is not refundable by the company as it amounts to a reduction of capital, as was pointed out in the above two cases. It was also laid down in the above cases that payment of interest on these calls paid in advance

even where there are no profits, or the company makes losses, would amount to a payment of capital there is nothing *ultra vires* in that. Even though an arrangement were to be made that money so lent as callls in advance should be treated in winding up as advance calls and that the shareholder should not be called upon to pay again, such an agreement would not be binding (*Burge's Case*, (1868) 5 *Eq.* 420; *Law Car Insurance Corporation*, (1912) 1 *Ch.* 405); neither can this advance money be set-off in winding up against calls made by liquidators, but on the contrary the shareholder has to pay up his calls made by the liquidator and thereafter in proving his claim as a creditor the amount he has lent to the company as calls in advance (*Grissell's Case*, (1866) 1 *Ch.* 528; see also *Burge's Case cited above*).

Enforcement of Calls and Limitation Act

The directors are in duty bound to enforce payment of calls by all means within their power and in this connection they have the right either to forfeit shares, or to sell them in exercise of the company's lien, or to file suits. The defence of a shareholder claiming a set-off against the payment of call is lost if liquidation intervenes (*Re. Hiran Maxim Lamp Co.*, (1903) 1 *Ch.* 70). Section 186 of the Indian Companies Act of 1913 makes it clear that a set-off in case of a limited company is not allowed in connection with calls made on a contributory in liquidation, but it allows certain latitude in case of unlimited companies where a contributory may be allowed by the Court to set-off any money due to him, or to the estate he represents, from the company on any independent dealing or contract with the company, but not any money due to him as a member of the company in respect of any dividend or profits. The only allowance made in case of a limited company is where a director with unlimited liability is concerned, who is also treated on the same footing as a contributory in an unlimited company. A call made after the death of a member is no doubt payable out of his

estate, but the calls unpaid at the date of the insolvency of a shareholder are only provable in insolvency under Sec. 46(3) of Presidency Towns Insolvency Act, 1909 and Sec 34 (2) of the Provincial Insolvency Act, 1920.

The period during which a call is to be enforced, under the Indian Limitation Act of 1908, Art. 112, is 3 years from the date on which the call is payable, if made by the company itself or its directors as a going concern. An application by Official Liquidator for calls is not subject to any limitation (*Per Farren, J., in Chambers, in Re. Cattiwar Trading Company*, reported in *Times of India* of 2nd May, 1887).

But if a suit is brought by the liquidator to recover calls in the name of the company and on its behalf, the same falls under Art. 120, which gives it a period of six years from the time the right to sue accrues (*Parel Spinning and Weaving Co., Ltd., (In liquidation)* v. *Maneck Haji*, (1886) 10 *Bom.* 483). This decision has been expressed to be open to some doubt by learned text writers as in their opinion such a suit is virtually a suit by the company within the meaning of Art. 112.

It is now enacted by the new Sec. 159 (1) of the Amendment Act of 1936 that *the liability of contributory shall create a debt payable at the time specified in the calls made on him by the liquidator.*

With respect to calls, it must be remembered that the shareholder's liability to pay the same here is statutory and cannot be got rid of by any device, or even by the unanimous vote of all the shareholders. Such an agreement would be void or illegal even though it may purport to be by way of compromise (*Mother Lode Mines, Ltd.* v. *Hill*, (1903) 19 *T. L. R.* 341). The only way in which a shareholder can relieve himself of his liability to pay for his shares is, (1) by paying the amount called from time to time, (2) by transfer of his share to somebody else; (but even here twelve months must expire after the transfer is made to relieve him from entire liability because he may be called upon to pay the unpaid balance as a

past member in case the transferee fails to pay the money in liquidation), (3) by forfeiture and (4) by means of reduction of the company's capital under the Act. To an action for recovery of calls misrepresentation is no answer unless prompt action is taken for rectification of the register either separately or by counter claim (*First National Re-Insurance Co.* v. *Greenfield,* (1921) 2 *K. B.* 260).

We have already seen that shares must be paid for in cash unless there is an agreement to allot shares in consideration of services or property. In the case of a contract to allot shares for consideration other than cash, we have seen that a copy of the said agreement has to be filed in the requisite time. If any default is made in this connection the company's officers are liable to penalties, but that does not make the allottee pay up for his shares in cash (*Prem Behari* v. *S. B. Billimoria,* (1926) 48 *All.* 503 *at p.* 507). Except as provided for in Sec. 105A, if there is an agreement to issue shares at a discount, the result would be that the person will have to pay for the balance up to the nominal value, on the winding up of the company (*Welton* v. *Saffery,* (1897) *A. C.* 299) and his liability will be the same even in case the company is a going concern. (*In Re. Pilkin & Co., Ltd.,* (1916) 85 *L. J. Ch.* 318). The fact that the market quotation for these shares is already below par would not justify issuing shares at a discount (*Ooregum Gold Company* v. *Roper,* (1892) *A. C.* 125). The company cannot issue its shares by way of gift or bonus for past services for which the company is not liable to pay or as an inducement to take debentures of the company (*Re. Eddystone Marine Insurance Company,* (1893) 3 *Ch.* 9; *Welton* v. *Saffery,* (1897) *A. C.* 299).

Estoppel Re. Share-Certificates

In connection with shares issued at a discount, distinction must be observed between that position and the position where the company issues shares as fully paid to

innocent third parties, though they were not so fully paid in fact. Here the innocent third party who receives the share-certificates as fully paid relying upon the company's own representation is protected, with the result that the shares will be treated as fully paid (*Parbury's Case*, (1896) 1 *Ch.* 100; *Burkinshaw* v. *Nicolls*, (1878) 3 *Ap. Ca*-1004; *Roland's Case*, (1880) *W. N.* 80; *Markham and Darter's Case*, (1899) 1 *Ch.* 414; *British Farmers' Co.*, (1878) 7 *Ch. D.* 533; *R. Concessions Trust*, (1896) 2 *Ch.* 757), and this position is not altered even though these shares may have been subsequently bought back by some person who was in possession of all the facts (*Ex parte Sandy's*, (1889) 42 *Ch. D.* 98; *Re. New Chile Gold Mining Co.*, (1892) *W. N.* 193). A case in point is (*Bloomenthal* v. *Ford*, (1897) *A. C.* 156) where money was lent by an innocent party to a limited company with the condition that he should have, as collateral security, fully paid shares in the company. The company handed him share-certificates for 10,000 shares of £1 each and represented that they were fully paid. As a matter of fact no money had been paid on these shares which were issued from the company direct to the party who believed that the representations made by the company were true. In this case it was decided that since the company had obtained the lien by a representation that the shares were fully paid, which was believed and acted upon by the other party, the company and the liquidators were estopped from alleging that the shares were not fully paid and that the appellant was entitled to have his name removed from the list of contributors. It was also here emphasised that it is not enough for the company to allege any defence that the other party might have or ought to have known that the shares were not fully paid when as a matter of fact he was not aware of that fact.

Where the purchaser bought the shares relying on the certificate issued by the company in which the statements were untrue the company was estopped from denying his title to the shares (*Bahia and San Francisco Ry. Co.*,

(1868) *L. R.* 3 *Q. B.* 584; *Ottos Copje Diamond Mines*, (1893) 1 *Ch.* 618; *Balkis Consolidation Co.* v. *Tomkinson*, (1893) *A. C.* 396). Of course if the purchaser bought with notice or knowledge that the representation in the certificate was not accurate he cannot invoke the doctrine of estoppel in his favour (*Crickmar's Case,* (1875) *L. R.* 10 *Ch. Ap.* 614). The onus, of course, lies on the person setting up a case of notice (*In Re. A. W. Hall & Co.,* (1887) 37 *Ch. D.* 712). The estoppel will arise in favour of a firm even though one of the directors signing the certificate is a member of the firm (*Coasters, Ltd.,* (1911) 1 *Ch.* 86). In one case of vendors' shares where the certificate did not represent them to be fully paid but there was an accompanying letter declaring them as fully paid the transferees escaped liability (*MacDonald Sons & Co.,* (1894) 1 *Ch.* 89). Where the certificate happened to be in custody of the company and the secretary had issued certified transfer and inadvertently also handed over the certificate to the transferrer the company was not held liable to third parties either for negligence or estoppel where the transferrer pledged same fraudulently (*Longman* v. *Bath Electric Tramways,* (1905) 1 *Ch.* 646). Where a secretary certifies a transfer where he is not so authorised an estoppel does not arise (*George Whitechurch, Ltd.* v. *Cavanagh,* (1902) *A. C.* 117).

Forms of Articles re. Calls

The manner in which the calls are to be made is determined by the articles of association and here the procedure laid down by the Articles must be strictly followed. The Table "A" gives a set of articles applying to calls being articles Nos. 12—17 inclusive. Specimen articles taken from precedents of Indian Companies, on the question of calls are as follows :—

CALLS ON SHARES

Calls. **The directors may, from time to time, make such calls as they think fit upon the shareholders in respect of all moneys for**

the time being unpaid on the shares held by them respectively, and not by the conditions of allotment thereof made payable at fixed times, and every shareholder shall be liable to pay the amount of every call so made on him to the persons and at the times and places appointed by the directors. A call may be made payable by instalments.

When call deemed to have been made.

A call shall be deemed to have been made at the time when the resolution of the directors authorising such call was passed.

Notice of Call.

Fifteen days' notice at the least shall be given by the company (either by letter to the members or by advertisement) specifying the time and place of payment appointed by the directors for the payment of every call made payable otherwise than on allotment.

Directors may extend time.

The directors may from time to time at their discretion extend the time fixed for the payment of any call and may extend such time as to all or any of the shareholders who from residence at a distance or other cause the directors may deem fairly entitled to such extension; but no shareholder shall be entitled to such extension save as a matter of grace and favour.

When interest on call or instalment payable.

If the sum payable in respect of any call or instalment be not paid on or before the day appointed for payment thereof the holder for the time being of the share in respect of which the call shall have been made or the instalment shall be due shall be liable to pay interest for the same at such rate not exceeding nine per cent per annum as shall from time to time be fixed by the directors, from the day appointed for the payment thereof to the time of the actual payment.

Evidence in action for call.

On the trial or hearing of any action for the recovery of any money due for any call, it shall be sufficient to prove that the name of the member sued is entered in

the register as the holder, or one of the holders, of the shares in respect of which such debt accrued; that the resolution making the call is duly recorded in the minute book; and that notice of such call was duly given to the member sued, in pursuance of these presents; and it shall not be necessary to prove the appointment of the directors who made such call, nor any other matter whatsoever, but the proof of the matters aforesaid shall be conclusive evidence of the debt.

Payment of Calls in advance.

The directors may, if they think fit, receive from any member willing to advance the same, and either in money or money's worth, all or any part of the capital due upon the shares held by him beyond the sums actually called for, and upon the amount so paid or satisfied in advance or so much thereof as from time to time exceeds the amount of the calls then made upon the shares in respect of which such advance has been made, the company may pay interest at such rate as the member paying such sum in advance and the directors agree upon.

Partial payment not to preclude forfeiture.

Neither the receipt by the company of a portion of any money which shall from time to time be due from any member to the company in respect of his shares either by way of principal or interest nor any indulgence granted by the company in respect of the payment of any such money shall preclude the company from thereafter proceeding to enforce a forfeiture of such shares as hereinafter provided.

Company may exercise powers conferred by Section 49 of the Act.

The company shall be entitled to do any one or more of the things specified in Section 49, sub-clauses (1), (2) and (3) of the said Act.

It may be added that whether a call is necessary or not, is a question which the directors have at their entire discretion to decide and the Courts of Law will not interfere unless it is clear that the call is made for an object

not within the powers of the company. (*Bailey* v. *Birkenhead Railway Company,* (1850) 12 *Beav.* 433; *Odessa Tramways* v. *Mendel,* (1878) 8 *Ch. D.* 235; *Const.* v. *Harris,* (1824) *Turn & R.* 496). The call which is made after the death of a shareholder or member is payable out of the estate (*New Zealand Gold Extraction Co.* v. *Peacock,* (1894) 1 *Q. B.* 622). In the case of bankruptcy of a member, the company has a right to prove not only for the call it has already made, but also for the estimated amount of future calls (*Re. McMahon, Fuller* v. *McMahon,* (1900) 1 *Ch.* 173). If a call happens to have been irregularly made it can be confirmed at a subsequent meeting where there is no irregularity (*Austin's Case,* (1871) 24 *L. T.* 932). A shareholder who is liable to pay calls cannot set off this debt against a debt due from the company to himself in winding up (*Re. Barrow-In-Furness Land Co.,* (1880) 14 *Ch. D.* 400).

Procedure in Connection with making of Calls

Here the secretary should know that in law the articles must be carefully studied and followed as they constitute a binding agreement between the company and the shareholders. They usually state that the resolution making the call must state the time and place for making the call and the secretary drafting the notice of the call has also to see that this fact is mentioned in the call letter as well as in the resolution concerned. The making of the call should be brought on the agenda of the meeting of the directors and where all the directors duly appointed and fully qualified must be present (*Howbreach Coal Co.,* v. *Teague,* (1860) 5 *H. & N.* 151, *Iron Ship Coating Co.* v. *Blunt,* (1868) *L. R.* 3 *C. P.* 484). The next thing is to see that a meeting of the directors has been duly convened with proper notice as laid down by the articles (*Garden Gulley United Q. M. Co.* v. *McLister,* (1875) 1 *A. C.* 39). The resolution should be duly passed at a meeting where a quorum is present and care should be taken to see that in this resolution the time and place of

payment as well as the amount of call and to whom payable must be stated. Appropriate entry should then be made in the minute book of this resolution. The slightest carelessness or irregularity on the part of the secretary in this regard might invalidate the whole call (*Pioneer Alkali Works Ltd.* v. *Amiruddin Salèbhoy Tyabji*, (1926) 50 *Bom.* 461). If the resolution making the call does not fix the date of payment the call will be invalid (*Cowley & Co.*, (1889) 42 *Ch. D.* 209). When this provision is there it must be strictly followed, otherwise the calls would be invalid (*Bhagirath Spinning & Weaving Co., Ltd.* v. *Balaji B. Powar*, (1930) 32 *Bom. L. R.* 87). Here it was also held that the call being invalid the resolution of forfeiture based on it was also *ultra vires* of the directors. If, however, the articles do not specify that in making calls the persons on whom the same is made and the place and time where the same is to be paid should form part of the resolution, then a call made by a resolution which does not comply with these steps is valid and effective (*Dhanraj K. Jhalani* v. *H. H. Wadia*, (1933) 35 *Bom. L. R.* 26). The articles usually provide for payment of interest if the call is not paid on or before a certain date, which fact should also be pointed out if possible in the letter of call. The rate of interest is usually high because the object is to penalise the defaulting member. The letters are printed and kept ready in anticipation of the passing of the resolution and the term and period of notice as provided for in the articles must also be complied with. The usual practice is to arrange with the company's bankers to receive the call money which is usually credited in a special account opened for the purpose. Companies do not generally arrange for receiving this cash themselves, as that would involve a lot of extra labour. The call letter should be sent away soon after the resolution, by registered post to the addresses of members as on the register of members. This can be easily done from the register of members itself where all particulars are readily available. Frequently call lists

are prepared stating the name and addresses of the member, the serial numbers of his shares, the share register folio, the amount due for call and the date on which paid and the actual amount paid are shown by separate columns. There is a special column reserved for remarks. This list is written up at the time the calls are made and as the money is being received. Frequently the share-certificates are also called in and the amount paid is endorsed on the share-certificate. The following is a specimen call letter :—

NOTICE OF CALL

This Form to be sent entire to the Bankers or the Secretary, accompanied by the amount payable.

Notice of call of Rs. 50 per share.

Making Rs. 150 per share paid-up.

No. 113, shares Nos. 1234—1243.

The Bombay Spinning & Weaving Co., Ltd.,

Bombay, 1st November, 1937.

SIR,

I have to inform you that at a meeting of the directors of this company held at Bombay on the 1st November, 1937, it was resolved that a call of Rs. 50 per share be made upon the members of the company in respect of the moneys unpaid on their shares payable on or before 15th November, 1937, and I have to request that you will, on or before that date pay the sum of Rs. 500 (being the amount of such call in respect of the 10 shares registered in your name in the books of the company) to the National Bank of India, Ltd.

I am, Sir,
Your obedient servant,
J. Fernandez, *Secretary*.

To,

Mr. Jivanji Pragji,
15, Churchgate Street, Bombay.

15th November, 1937.

No. 113.

Stamp

The National Bank of India Ltd.,
Bombay.

Received of Jivanji Pragji the sum of Rs. 500 being the

amount of a call of Rs. 50 per share on 10 shares in the Bombay S. & W. Co., Ltd.
Rs. 500.

Dosabhai Framji,
Receiving Cashier.

The Form of Resolution will be more or less as under :—

"Resolved that a call of Rs. 50 per share be and is hereby made upon the members of the company in respect of the amount unpaid on their shares and that the same be payable on or before the second day of June, 1937 to the Bombay office of company's bankers, the Bank of India Limited, Esplanade Road and that all calls unpaid by that date shall bear interest at the rate of nine per cent per annum from the day when same was payable until payment.

The secretary is hereby instructed to issue the necessary call notices and arrange with the company's bankers as aforesaid for the collection of the said call moneys.

The form of endorsement on share-certificate is as follows :—

"Certified that the first call of Rs. 50 per share due on the second day of June, 1937 making in all Rs. 250 paid up has been duly paid."

For the All-India Trading Corporation Limited,

R. Govindji & Sons,
Secretaries and Managing Agents.

Bombay, 5th June, 1937.

CONVENIENT DAYS FOR MAKING CALLS

With reference to correct and the most convenient days for making calls payable particularly at bankers, the Institute of Bankers, England in the report of the committee appointed by them to deal with company application, allotment and call forms states that as the collection of these application money, allotment money and call money in case of large company entails very heavy work on bankers, it would be a great convenience if as few calls as possible were made payable on the first and last days of each month, on Saturdays and Stock Exchange settlement days, or during the first or last week of each half

year. They also suggest that it would be best before fixing these dates of payment, if the bankers are consulted. They also suggest that where allotment is to be made within a very reasonable time of the application, the practice of giving stamped receipts for applications may be avoided and instead there should be one receipt both for the application and allotment money. This would, in case of very large number of applications to be dealt with, save both time and unnecessary expense. They point out that in case of Government and other public loans such receipts for application money are seldom seen. They also advise that the form of remittance in connection with application, allotment and call money should be clearly indicated in the exact words in the letters of allotment and call letters. They state that a "bearer" cheque "crossed" not negotiable is the safest medium for remittance and it would also save an amount of labour in endorsing thousands of cheques received on account of remittances, if they have to be order cheques.

What the Company can do as to Calls

The Act lays down the following regulation in Section 49 applying to calls :—

A company if so authorised by its articles, may do any one or more of the following things, namely :—

(1) make arrangements on the issue of shares for a difference between the shareholders in the amounts and times of payments of calls on their shares;

(2) accept from any member who assents thereto the whole or a part of the amount remaining unpaid on any shares held by him although no part of that amount has been called up;

(3) pay dividend in proportion to the amount paid up on each share where a larger amount is paid up on some shares than on others.

Thus it will be seen that calls are virtually speaking claims made in instalments or otherwise for the balance of the unpaid amount of a share made by the board of directors or the company prior to winding up, or by the

liquidator in the course of winding up of the company. As we have already seen that the articles provide for the making and payment of calls generally and the Act on that point is silent.

Reserve Liability

Section 69 provides for what is known as "reserve liability" in case of limited companies and runs as follows :—

"A limited company may by special resolution determine that any portion of its share capital which has not been already called up shall not be capable of being called up, except in the event and for the purposes of the company being wound up, and thereupon that portion of its share capital shall not be capable of being called up except in the event and for the purposes aforesaid."

Here it will be seen that either by original article or by a special resolution passed thereafter, the reserve liability or reserve capital may be created. We have already seen that a special resolution passed by a limited company in terms of Section 69 is irrevocable but reserve capital created by an article in the articles of association may be altered or revoked by a special resolution and the reserve capital called up (*Malleson* v. *The National Insurance Corporation,* (1894) 1 *Ch.* 200). The reserve capital created by a special resolution cannot be even charged or mortgaged (*Bartlett* v. *Mayfair Property Co.,* (1898) 2 *Ch.* 28).

The Position of a Call as a Debt

A call once made becomes a debt (Section 21 (2)), otherwise the liability to pay calls when made is not a debt (*Whittaker* v. *Kershaw,* (1890) 45 *Ch. D.* 320). While the company is a going concern a shareholder may set off a call against the money due to him by the company or even against future calls but this cannot be done in connection with a debt which is payable at a future date (*Adamson's Case,* (1874) *L. R.* 18 *Eq.* 670; *re. Jones*

Lloyd & Co., (1889) 41 *Ch. D.* 159; *Habershom's Case*, (1868) *L. R.* 5 *Eq.* 286). If an agreement is made that calls shall be paid by future supply of goods it is invalid (*Pellatt's Case*, (1867) *L. R.* 2 *C. A.* 527). If shares are mortgaged and mortgagee pays calls on them he is not entitled to recover the amount from the mortgagor unless there is an agreement or express stipulation to that effect (*Birdichand* v. *Standard Bank*, (1918) 42 *Bom.* 159). If a transfer is made after a call is made knowingly the liability is not transferred to the transferee (*Odessa Tramways Co.* v. *Mendel*, (1878) 8 *Ch. D.* 235, *Bailey* v. *Birkenhead Railway Co.*, (1850) 12 *Beav.* 433). If an article is originally framed providing that the reserve liability shall be created by special resolution that fact does not of itself create same unless such a resolution is passed (*Malleson* v. *National Insurance Co.*, (1894) 1 *Ch.* 200). A call irregularly made may be confirmed at a subsequent meeting which is regular (*Austin's Case*, (1871) 24 *L. T.* 932). It has also been held that where various groups of shareholders are arranging a compromise, those shareholders who have paid their calls in advance must be treated as separate calls and their meeting should be separately called if the scheme of compromise affects their position (*United Provident Assurance Co.*, (1910) *W. N.* 199).

Calls on Different Classes of Shares

It may be added here that in the case of many companies where shares of different denominations are issued such as preference, ordinary and deferred shares, in order to distinguish and differentiate the application, allotment and call letters as well as receipts connected therewith, stationery of specified colour is used such as white for preference shares, yellow for ordinary shares and pink for deferred shares. Some companies further distinguish the application, allotment and calls by printing on the right-hand corner of these letters a small one-fourth inch block with letters such as A. F. for Applica-

tion Form, A. L. for Allotment Letters, C. 1. for first call, C. 2. for second call and so on.

Call List

Though it is not quite necessary nowadays to prepare a call list because the usual form of the register, of members gives all the information that is necessary in many cases, such a list is prepared for convenience more or less in the form as given on the next page No. 447.

LIEN ON SHARES

A company can exercise a right of lien on shares if so authorised by its articles of association. It is the usual practice to reserve such powers in the articles. By virtue of this right the company is able to obtain a charge on the shares of any of its members for any debt due by the said member to the company (*Bank of Africa* v. *Salisbury Gold Co.*, (1892) *Ap. Cas.* 281; *Re. Macmurdo,* (1892) *W. N.* 73). When the lien is given on shares it usually extends to dividends also. It may be mentioned that unless the article reserve this right the company has no such lien in common law (*Murray* v. *Pinkett,* (1845) 12 *Ch. and F.* 764; *Dunlop* v. *Dunlop,* (1882) 21 *Ch. D.* 583). When the articles reserve such powers, they also empower the company to enforce its lien by a sale. In such a case the purchaser of the shares will be placed on the register and the member whose shares have been sold, removed with respect to the said shares. It must be, however, noted that where a company has power both to forfeit shares, and to enforce a lien, it cannot enforce its lien by a forfeiture. If the company wishes to exercise the power of forfeiture in respect of any debt in arrear, it should expressly reserve the power to forfeit shares for non-payment of any debt due to the company (*Dunlop* v. *Dunlop,* (1882) 21 *Ch. D.* 583). In case of a purchaser from the company, who has bought the shares on which calls were in arrear, and on which the company had exercised a lien, it was held that he was not liable on calls

FORM OF

CALL LIST

THE BOMBAY SPINNING AND WEAVING CO., LTD.

Second and Final Call of Rs. 2 per share on 50,000 Ordinary Shares of Rs. 10 each.

Date call made December 2, 1933, payable on or before December 20th, 1933.

No. of Call Letter	Share Ledger Folio	Shareholder			No. of Shares held	Amount of Call due at Rs. 2			Paid					Outstanding							Remarks
		Name	Address	Business or Profession					C. B. Folio	Date	Amount			Amount			No. of days	Interest due			
						Rs.	A.	P.		1933	Rs.	A.	P.	Rs.	A.	P.		Rs.	A.	P.	*Note.*--This column is reserved for taking notes as to any instructions that may have been received from the member as to application to bankers powers of attorney, etc. or for further calls.
240	1-47	N. K. Desai	Princess Street	Merchant	100	200			21	Dec. 3	200										
241	1-48	M. N. Shah	17 Cavel Street	Teacher	200	400			22	,, 4	400										
242	1-49	B. K. Gupta	41 Hughes Road	Foreman	300	600			23	,, 6	600										
243	1-50	S. K. Sen	21 Grant Road	Jeweller	400	800			23	,, 8	800										

in arrear, but was liable to have a fresh call made on him for the like amount (*Randt Gold Mining Co.* v. *New Balkis Eerstelling*, (1904) *A. C.* 165). In *Bradford Bank Co.* v. *Briggs*, (1886) 12 *A. C.* 29, where according to the articles, the company was to have a first and paramount lien over the shares for non-payment of calls, etc., and where a shareholder had mortgaged his shares against a loan by deposit at the bank and the bank had given due notice of such deposit to the company whose shares they were and the shareholder in course of trading with the company thereafter became indebted to the company, it was held that the company having notice of the deposit cannot claim to enforce the lien given by the articles for a debt incurred subsequent to the notice. It was held here that the bank which had given notice of this mortgage was not giving a notice of trust (S. 33); but only sought to affect the company in their capacity of traders with notice of interest of the bank (See also *Mackereth* v. *Wigan Coal & Iron Co.*, (1916) 2 *Ch.* 293).

A lien on shares can be enforced even on trustees as the shares are on the register on their names and no notice of trust can be placed on the register and the logical consequence is that the lien cannot therefore be claimed on such shares on personal name of the trustees in respect of the debts due by the *cestui qui trust* who is in reality the beneficial owner.

A purchaser of shares which are subject to a lien is bound by it. The exercise of a lien makes the company a secured creditor in bankruptcy (*In Re. Collie, Ex parte Manchester and Country Bank*, (1876) 3 *Ch. D.* 481). The lien when given against the holder of the shares it applies of course to the registered holder only (*Pauls' Trustees* v. *Justice*, (1912) *S. C.* 1303 *Crt. Sess.*)

In Re. W. Key & Son, Ltd., (1902) 1 *Ch.* 467, it was further decided that a company has no right to enter a note or memorandum either on their register or on the share-certificate as to its lien or claim on the said shares.

A lien may be taken by altering the articles after

the issue of the shares (*Allen* v. *Goldreefs of West Africa,* (1900) 1 *Ch.* 656).

The effect of the lien is that the company becomes a secured creditor as far as these shares are concerned in the case of bankruptcy of the shareholder (*Re. Collie,* (1876) 3 *Ch. D.* 481). If the articles are properly worded the lien would extend to all liabilities, not only to those in respect of shares and may even apply to joint as well as several debt (*Bentham Mills Spinning Co.,* (1879) 11 *Ch. D.* 900). If, however, a debt is incurred on shares, say by making of a call after the date a transfer of share has been lodged, the lien cannot be enforced with respect to such a debt (*Cawley & Co.,* (1889) 42 *Ch. D.* 209).

Table " A " provides Articles Nos. 9, 10 and 11 which deal with the exercise of lien and the power of sale of the company which may be referred to in the Appendix " C " Vol II. The usual Clauses to be found in the Articles of Indian Companies are as follows :—

Company's lien on shares.

The company shall have a first and paramount lien upon all the shares registered in the name of each member, whether solely or jointly with others, (Note :—Some companies also add the words " and upon the proceeds of sale thereof ") for his debts, liabilities and engagements on any account whatever to or with the company from him alone or jointly with any other person or persons, whether time for payment, fulfilment or discharge thereof, shall have actually arrived or not, and no equitable interest in any share shall be created expect ıpon the footing and condition that this clause is to have full effect, and where a share is held by more persons than one, the company shall have a lien thereon in respect of the debts, liabilities or engagements to the company from all or any of the holders thereof. The company's lien shall extend to all dividends and bonuses from time to time declared in respect of all such shares. Unless other-

29

wise agreed, the registration of a transfer of shares shall operate as a waiver of the company's lien, if any, on such shares.

Note :—Some articles provide instead "first and paramount lien" extending over "all shares" a lien only on "all the shares other than fully paid up shares." There is also a clause frequently inserted as follows :—"The directors may at any time declare any share to be wholly or in part exempt from the provisions of this clause."

As to enforcing lien by sale.

The shares of any member who may be indebted to the company may be sold by order of the directors, to satisfy the company's lien thereon and be transferred into the name of the purchaser without any consent and notwithstanding any opposition on the part of the indebted member and or the joint holder or holders of any; and a complete title to the shares of any member alleged by the directors to be indebted to the company, which shall be so sold and transferred, shall be acquired by the purchaser by virtue of such sale and transfer against such indebted member and or his joint holder or holders, and all persons claiming under him or them, whether he may be indebted to the company in point of fact or not; but no such sale shall be made until notice in writing of the intention to sell shall have been served on such member, his executors or administrators and default shall have been made by him or them in the payment, fulfilment or discharge of such debts, liabilities or engagements for seven days after such notice.

Application of proceeds of sale.

The net proceeds of any such sale shall be applied in or towards satisfaction of the said debts liabilities or engagements and the residue if any, paid to such member his executors, administrators or assigns.

Note :—The following clause is also frequently added :—

"Upon any sale after forfeiture or

Validity of Sale.

for enforcing a lien in purported exercise of the powers hereinbefore given, the directors may cause the purchaser's name to be entered in the register in respect of the shares sold and the purchaser shall not be bound to see to the regularity of proceedings, or to the application of the purchase money and after his name has been entered in the register in respect of such shares the validity of the sale shall not be impeached by any person, and the remedy of any person aggrieved by the sale shall be in damages only and against the company exclusively."

There is an alternative clause on this as follows :—

"Any entry in the minute book of the company of the forfeiture of any shares or that any shares have been sold to satisfy a lien of the company shall be sufficient evidence as against all persons entitled to such shares, that the shares were properly forfeited or sold; and such entry, and the receipt of the company for the price of such shares constitute a good title to such shares and the name of the purchaser shall be entered in the register as a member of the company, and he shall be entitled to a certificate of title to the shares and shall not be bound to see to the application of the purchase money nor shall his title to the said shares be affected by any irregularity or invalidity in the proceedings in reference to the forfeiture or sale. The remedy of the former holder of such shares and of any person claiming under or through him shall be against the company in damages only."

Another alternative clause is as follows :—

No purchaser shall be bound or concerned to inquire into the application of the purchase money or the regularity of the sale but the remedy of any one injured by a sale wrongfully made in purported exercise of such power of sale shall be in damages against the company only.

Declination of Notice of Lien or Charge

It should be further noted that a company which receives a notice of any lien or equitable interest must according to Sec. 33 decline to recognise it. This section lays down that no notice of any trust expressed, implied, or constructive, shall be entered on the register or be receivable by the registrar. Thus the company is not concerned or bound to recognise a trust or equitable interest and usually when such a letter is received from a banker or others, the practice is to send a formal answer in more or less the following form :—

The Bombay Trading Co., Ltd.,
Esplanade Road, Fort,
Bombay, *12th January, 1937.*

The Manager,
Bank of Bombay and Calcutta Limited,
Hornby Road, Bombay.

DEAR SIR,

I am in receipt of your letter of the 10th instant which purports to be a notice of the deposit of certain certificates of shares of this company with your Bank. In reply I have to inform you that the company and its officers are unable to recognise, or in any way act upon any such notice or communication.

I have therefore to return the said communication herewith.

For The Bombay Trading Co., Ltd.
Pestonji F. Dinshaw,
Secretary.

The above section no doubt lays down the rule very necessary for the protection of companies which is frequently reiterated in the articles. It must be however noted that though the company is not bound to recognise any equitable interest, the Court will protect and enforce rights of this character. In one case an equitable mortgagee of shares was held to be entitled to sue the company for the recovery of dividend payable in respect of mortgaged shares (*Binney* v. *Ince Hall Coal Co.*, (1866) 35 *L. J. Ch.* 363).

Position of Equitable Mortgagee

In a Privy Council case an equitable mortgagee of shares was held entitled to priority over the company which had attached under a decree the shares for a debt incurred by the shareholder after the date of the equitable mortgagee in spite of the fact that the company had no notice of the charge (*Bank of N. T. Butterfield & Son* v. *Golinsky,* (1926) *A. C.* 733). In a House of Lord's case the bank gave notice to the company of the deposit of shares as security against advance made by the bank and though the company had the first and paramount lien by its articles on the shares for debts due to it, it was held that for any money advanced, or debt incurred after the notice by the bank to the company, the company was not to have a priority (*Bradford Banking Co.* v. *Briggs,* (1887) 12 *A. C.* 29; *Reardon* v. *Provincial Bank of Ireland,* (1896) 1 *Ir. R.* 532 *C. A.; Binney* v. *Ince Hall Coal Co.,* (1864) 35 *L. J. Ch.* 363).

Company's Lien

Lien, generally speaking, under the ordinary law of contracts, gives a right to the creditor to detain the article, but does not give him the right to sell same and what is therefore to be done is that the creditor should file a suit and obtain a decree, which decree he could enforce against the property on which he has exercised the lien. In case of joint stock companies however the special article which provides for this lien also gives power of sale, so that there is no difficulty in this connection. However, it has been held, in England, that the right of lien as given to a joint stock company is not a right of retaining, but amounts to an equitable charge upon the shares which involves the right to sell and thus the company has the right to sell whether the articles expressly provide for it or not (*General Exchange Bank Re. Lewis,* (1871) 6 *Ch.* 818 ; *Everitt* v. *Automatic Weighing Machine Company,* (1892) 3 *Ch.* 506). It has been however held that though the company can enforce a lien by the sale of a

share, it has no power to forfeit the share for non-payment of any debt due to the company (*Hopkinson* v. *Mortimer & Co.*, (1917) 1 *Ch.* 646). When the company enforces this right to sell, all that it is bound to do is to place the purchaser on the register of members and such a registered member has no right to see to the obligations attached to the purchase money. Company's lien is an equitable mortgage and is assignable (*Everitt* v. *Automatic Weighing Machine Co.*, (1892) 3 *Ch.* 506). The lien is lost if the company registers a transfer of shares which are subject to the lien (*Higgs* v. *Assam Tea Co.*, (1869) *L. R.* 4 *Exch.* 387). We have seen that where the articles contain what is commonly known as "exemption clause" which relieves the company from the obligation to take notice of equities in relation to its shares, the company can exercise its lien even if the shareholder was a trustee. This "exemption clause" is a part of the specimen articles of association which we have given above and the words "and no equitable interest in any share shall be created except upon the footing and condition that this clause is to have full effect" covers that point. Lord *Coleridge*, C.J., sitting in the Court of Appeal in *Re. Perkins,* (1890) 24 *Q. B. D.* 613 stated that "it seems to me extremely important not to throw any doubt on the principle that companies have nothing whatever to do with the relations between trustees and their *cestuis que trust* in respect of the shares of the company. If a trustee is on the company's register as a holder of shares the relations which he may have with some other person in respect of the shares are matters with which the company has nothing whatever to do; they can look only to the man whose name is upon the register. It seems to me that if we were to throw any doubt upon that rule, we should make the carrying on of their business by joint stock companies extremely difficult, and might involve those companies in very serious questions, and the ultimate result would be anything but beneficial to the holders of shares in such companies themselves."

The lien is generally enforced by a sale of the shares

and articles which specially provide for a lien also give power to the company to enforce the same on default by sale. In the absence of such power in the articles it may be necessary to apply to the Court. It may, however, happen that the articles provide that, in case the mortgagee takes a mortgage with notice of the company's lien, his claim shall be postponed, then, the regulation will hold good. Even if the article provides that a member may be compelled to sell his share against which the lien is applied at a price less than their value the clause is valid (*Phillips* v. *Manufacturers Securities,* (1917) 86 *L. J. Ch.* 305).

LIEN ON TRUST SHARES

The rule which says that when shares are held by trustees in their personal name, the company can exercise the lien given to it by articles on these shares for the debt of the trustees themselves is of limited application. Thus where the company has notice that these shares registered in the name of a particular person were trust property and that that person was a trustee, they cannot assert a lien against a trustee who may be indebted to the company and on the same principle they cannot decline to register a transfer of the shares by the trustees in due course of acting on the trust because the company wants to preserve its lien on one of the trustees indebted to it (*Mathieson* v. *Gronow,* (1929) 45 *T. L. R.* 604). Neither can the company assert a lien on the shares held in the name of the trustees for the debts owing to it by the *cestui que trust* (*Re. Perkins,* (1890) 24 *Q. B. D.* 613). If the company knew, when it makes advance, that the shares were held in trust, the lien cannot be enforced against the trustees who held the shares (*Mackereth* v. *Wegan Coal and Iron Co.,* (1916) 2 *Ch.* 293). When the articles stated that the lien is to be exercised against " holders of shares " it means registered holder (*Paul's Trustees* v. *Justice,* (1912) *S. C.* 1303 *Court of Sessions*). The purchaser of shares against whom lien is claimed by the company has a right to require the company to first exercise its right

against shares which are remaining in the hands of a vendor and then for the surplus if any, to resort to lien on the shares sold to the purchaser (*Gray* v. *Stone,* (1893) 69 *L. T.* 282; *W. N.* 133). We have seen that a lien may be taken by altering the articles after the shares are issued, but that will not apply against a transfer which was lodged before the resolution creating the lien by the articles is passed (*McArthur* v. *Gulf Line,* (1909) *S. C.* 732 *Court of Sessions*). It is usual for companies to lend money on the security of the lien unless the articles forbid them from doing so (*National Bank Wales, In re. Cory's Case,* (1899) 2 *Ch.* 629).

Minors and Married Women as Shareholders

As we have noticed in a prior chapter in the case of a minor or an infant that the directors ought not to allot shares to him, because though an infant may become a member, that membership would be subject to his right to repudiate the shares when he attains majority. Till disaffirmed the infant's contract is valid (*Capper's Case,* (1868) 3 *Ch. App.* 458; *Pugh & Sharman's Case,* (1872) 13 *Eq.* 566; *Re. Laxon & Co.,* (1892) 3 *Ch.* 555; *Lunsdon's Case,* (1868) 4 *Ch.* 31; *Symon's Case,* (1870) 5 *Ch.* 298; *Dublin & Wicklow Ry. Co.* v. *Black,* (1852) 8 *Ex.* 181). The minor also should not subscribe to the memorandum of association, for although the registrar's certificate is conclusive evidence that the company is duly registered, the registrar would refuse to accept the memorandum, or grant the certificate of incorporation if he had reason to believe that the memorandum was not signed by adults. The company itself has power to refuse to accept the minor as a shareholder or transferee of shares (*Symon's Case,* (1870) 5 *Ch. App.* 298; *Castello's Case,* (1869) 8 *Eq.* 504) and should do so as a matter of duty particularly where the liability for payment of calls is carried by the shares (*Dublin & Wicklow Railway Company* v. *Black,* (1852) 8 *Exch.* 181). If the company transferred shares to a minor, it can repudiate the same if it was not aware

of this fact and the transferor would be held liable by being restored to the register of members or list of contributories (*Symon's Case,* (1870) 5 *Ch. App.* 298; *Castello's Case,* (1869) 8 *Eq.* 504; *Massey & Griffin's Case,* (1907) 1 *Ch.* 582). For directors to allot shares to an infant knowingly is a misfeasance (*Re. Wilson's ex parte, Crenver &c. Co.,* (1873) 8 *Ch. App.* 45). When the infant repudiates his shares on attaining his majority he can recover any sums he has paid to the company in respect of these shares, provided he has derived no benefit from the shares (*Hamilton* v. *Vaughan Sherrin Co.,* (1894) 3 *Ch.* 589; overruled by *Steinbarg* v. *Scala* (*Leeds*) *Ltd.,* (1923) 2 *Ch.* 452). But it has been held that if he insists on retaining the shares, he retains them with all obligations attaching to them even while he happens to be an infant, such as the liability for calls (*Cork & Bandon Railway Company* v. *Cazenove,* (1847) 10 *Q. B.* 935). This means that as long as he does not repudiate the shares he is a member of the company both for the benefits and burdens (*Lumsden's Case,* (1868) 4 *Ch.* 31; *Re. Laxon & Co., No.* 2, (1892) 3 *Ch.* 555). This repudiation must be done either during minority or within a reasonable time after attaining majority. What amounts to a reasonable time would naturally vary according to the circumstances of each case, but the rule which is followed is that the receipt of benefit would determine the right to repudiate after attaning majority. In some cases one or two years' delay has been considered sufficient to put an end to the right, but in others nearly three years' delay was allowed (*Ebbett's Case,* (1870) 5 *Ch.* 302; *Mitchell's Case,* (1870) 9 *Eq.* 363; *Hart's Case,* (1868) 6 *Eq.* 512). In one other exceptional case a woman who had received no benefits under a settlement was permitted to repudiate after thirty-seven years (*Ferrington* v. *Forrester,* (1893) 2 *Ch.* 401). Where a transfer is repudiated either by the minor or the company the transferrer is restored on the register of members or the list of contributories (*Capper's Case,* (1868) 3 *Ch.* 458; *Westons Case,* (1870) 5 *Ch.* 614; *Castello's Case,*

(1869) 8 *Eq*. 504; *Symon's Case,* (1870) 5 *Ch*. 298). The fact that the transferrer was ignorant to the minority of the transferee would make no difference (*Litchfield's Case,* (1849) 3 *De. G. & Sm.* 141; *Maun's Case,* (1868) 3 *Ch.* 459), where a purchaser who has not taken the shares on his own name procures the transfer to be on a minor's name with the result that the party transferring remains liable as the shares the purchaser will be bound to indemnify the transferrer and that where the minor happens to be beneficial owner of the shares (*Maitland's Case,* (1868) 38 *L. J. Ch.* 554; *Edwards Case,* (1869) *W. N.* 211). In another case where a director procured allotment of shares to his infant children and when the company went into liquidation they were still infants, he was held liable to make good the loss caused to the company by the latter's inability to enforce calls (*Crenver Co., ex parte Wilson,* (1873) 8 *Ch.* 45). Where a parent applied in the name of a minor son, the parent was put on the list of contributories (*Reichardson's Case,* (1875) 19 *Eq.* 589), transfers of shares by infants can only be made in accordance with an order of a Court of competent jurisdiction.

As to a married woman she may subscribe to a memorandum of association. As long as a married woman has her own separate property there is no reason why she should not hold shares in her own right independently of her husband. Formerly it was the practice of some companies to ask the husband to join when a married woman applied for shares to be transferred to her, but now this practice is practically non-existent. There were also articles in some old companies which authorised directors to refuse, if they so thought fit, the transfer to a married woman and thus they were not bound to admit a married woman as a member unless they accepted her for reasons of their own.

JOINT-HOLDERS OF SHARES

There is no objection to shares being held jointly by two or more persons and one of the joint holders may be

a corporation. Under the Indian Companies Act, 1913 it is provided by S. 2 (13) that where two or more persons hold one or more shares in a company jointly, they shall for the purpose of the definition of a private company be treated as a single member. When one of the joint holders die the survivors are entitled to the shares, but before they are allowed to transfer these shares, or deal with them in any other way, they must be required to produce evidence of the death of the former co-owner. When the articles are properly worded a lien on shares jointly held may apply both for the joint as well as several debts (*Bentham Mills Spinning Co.,* (1879) 11 *Ch. D.* 900).

The articles generally provide as to how these joint holders of shares should vote and most of them state that the first named joint holder on the register shall exercise such power. In this case the joint holder who is entitled to vote can also give a proxy without the concurrence of other joint holders. In case of a requisition to call a general meeting all the joint holders of shares should join by signing it, unless the articles specifically authorise one to sign for all and in absence of such an article, the signature of one on behalf of all is of no avail (*Patent Wood Keg Syndicate* v. *Pearse,* (1906) *W. N.* 164). In one case where the articles provided that only the member first named could vote, the Court with a view to protect the voting rights of joint holders ordered the names to be so entered in the register that in respect of some of the shares one name came first and in case of the others the other member's name was entered first (*Burns* v. *Siemens Brothers Dynamo Works,* (1919) 1 *Ch.* 225; *In Re. Hobson, Houghton & Co.,* (1929) 1 Ch. 300). In case of qualification of a director, shares held by him jointly with another person are sufficient for the purpose of measuring his qualification unless the Articles provide for sole holding (*Dunstter's Case, Re. Glory Paper Mills,* (1894) 3 *Ch.* 473).

Where there are joint holders the transfer must be signed by all to be effective and in case the signature or

any one is forged the whole transfer will be void (*Barton* v. *London and North Western Rail Co.*, (1890) 24 *Q. B. D.* 77). The joint holders can arrange to get their names entered in the register in whatever order they like (*Burns* v. *Siemens Bros. Dynamo Works Ltd.*, (1919) 1 *Ch.* 225).

SPECIMEN ARTICLES FOR JOINT-HOLDERS

The first named of joint-holders deemed sole holder.

If any share stands in the names of two or more persons, the person first named in the register shall, as regards receipt of dividends or bonus, or service of notices and all or any other matters connected with the company, except voting at meetings and the transfer of the share, be deemed the sole holder thereof, but the joint-holders of a share shall be severally as well as jointly liable for the payment of all instalments and calls due in respect of such share, and for all incidents thereof according to the company's regulations.

Death of one or more joint-holders of shares.

In the case of the death of any one or more of the persons named in the Register as the joint-holders of any share, the survivor or survivors shall be the only persons recognised by the company as having any title to or interest in such share; but nothing herein contained shall be taken to release the estate of a joint-holder from any liability on shares held by him jointly with any other person.

In some companies the following specimen article appears :—

Any one of joint-holders deemed sole holder.

If any share stands in the names of two or more persons, any one of them shall, as regards receipt of dividends or bonus, service of notice and all or any other matters connected with the company, except voting at meetings and the transfer of shares be deemed the sole holder thereof but the joint-holders of a share shall be severally as well as jointly liable for the payment of all instalments and calls due in respect of such shares and for all

incidents thereof according to the company's regulations.

An alternative set of articles used by some companies take the following form :—

Joint-holders.

Where two or more persons are the holders of any share they shall be deemed to hold the same as joint tenants with benefit of survivorship, subject to the provisions followng :—

(*a*) The company shall not be bound to register more than three persons as the holders of any share.

Liability several as well as joint.

(*b*) The joint-holders of any share shall be liable, severally as well as jointly, in respect of all payments which ought to be made in respect of such shares.

Survivors of joint-holders only recognised.

(*c*) On the death of any of such joint-holders the survivor or survivors shall be the only person recognised by the company as having any title to such shares; but the directors may require such evidence of death as they may deem fit.

Receipts.

(*d*) Any one of such joint-holders may give effectual receipts for any dividend, bonus or return of capital payable to such joint-holders.

Who entitled to certificate, votes, &c.

(*e*) Only the person whose name stands first in the register of members as one of the joint-holders of any share shall be entitled to deliver of the certificate relating to such share, or to receive notices from the company, or to attend or vote at general meetings of the company, and any notice given to such person shall be deemed notice to all the joint-holders : but any one of such joint-holders may be appointed the proxy of the person entitled to vote on behalf of the said joint-holders, and as such proxy to attend and vote at general meetings of the company.

SHARES WITH EXECUTORS AND ADMINISTRATORS

When a deceased has left shares with a personal representative, *viz.*, the executor or administrator, it is the duty of such personal representative to see that before paying away legacies, he keeps back sufficient cash with a view to meet the liability by way of calls on these shares. This has to be particularly done when the winding up is pending and where he does not do so, he will have to make good the money to the liquidator himself (*Taylor* v. *Taylor*, (1870) 10 *Eq.* 477 : *Re. Bewley, Re. Jefferys* v. *Jefferys*, (1871) 24 *L. T.* 177). Generally when the company has gone into liquidation, the Court will set aside a sum, in an administration action to meet the liability on the shares on amount unpaid, even though no calls have been made, but where the company has not gone into liquidation, the Court will not order a sum to be set aside and the legal representative will be fully protected if he pays out the amount to the heirs and persons entitled under an order of the Court in an administration action (*King, Re. Mellor* v. *South Australian Land Co.*, (1907) 1 *Ch.* 72). See also in *Re. Griffiths*, (1880) *W. N.* 159). The usual practice for the executors and administrators is to distribute the assets after giving statutory advertisements. If they did not know of the shares at the date of distribution they would be protected, but not otherwise (*Russell's Executor's Case*, (1871) 15 *Sol. J.* 790; *Cole's Executor's Case*, (1871) 15 *Sol. J.* 711; *Markwell's Case*, (1873) 21 *W. R.* 135). Here the executors also will be put on the list of contributors in their capacity as executors so that if there are any further assets, they could be utilised for the meeting of this liability. If the moneys were paid away to residuary legatees by the executors or administrators, they may be recovered, together with the cost and expenses incurred by the personal representatives in relation to the shares, if at the time of making payment the liability was a mere contingent claim which had not ripened into a debt, *i.e.*, there was no winding up and no call had been made but

not in any other case. (*Whittaker* v. *Kershaw,* (1890) 45 *Ch. D.* 320; *Jervis* v. *Wolferstan,* (1874) 18 *Eq.* 18). Even though executors are not on the register of members they can give notice of dissent in reconstruction. (*Llewellyn* v. *Kasintoe Rubber Estates,* (1914) 2 *Ch.* 670) Of course, they are not liable for the payment of unpaid calls even though they are placed on the register of members without their consent (*Buchan's Case,* (1879) 4 *Ap. Cas.* 549), articles usually give powers to the legal personal representatives to vote at meetings on proof of transmission and the Courts are inclined to construe same liberally (*Marks* v. *Financial News,* (1919) *W. N.* 237). Though a single executor can sign on behalf of himself and his co-executors, that cannot be done if they are registered as shareholders and in such cases all must sign for effecting a transfer (*Barton* v. *North Staffordshire Railway Co.,* (1888) 38 *Ch. D.* 458; *Barton* v. *L. & N.-W. Railway Co.,* (1889) 24 *Q. B.* 77). Where executors transfer shares to one of their number such a transfer will be treated as *prima facie* regular (*Grundy* v. *Briggs,* (1910) 1 *Ch.* 444). Generally articles provide for notices of meetings to be sent to the legal personal representatives of the deceased shareholder, but where there is no such provision, the representatives are not entitled to any notice (*Allen* v. *Gold Reefs of West Africa,* (1900) 1 *Ch.* 656). The position of legatees who accept a legacy of shares will be that they are liable to indemnify the personal representative, but they can notwithstanding exercise their option of disclaiming the shares, because the mere fact that they have obtained a notice in *lieu of distringas* on the strength of an affidavit, stating that they believe they are interested in the shares, does not preclude them from exercising this right of disclaimer (*Hobbs* v. *Wayet,* (1887) 36 *Ch. D.* 256).

LOANS ON SHARES

Frequently loans are given by bankers and others on shares and debentures of joint stock companies. The

most simple form of these loans is where the certificates are deposited with blank transfers and an agreement verbal or written is made to the effect that they are to be treated as securities for the payment of money advanced. Where time is fixed it applies, otherwise the loan will be treated as repayable on demand (*Deverges* v. *Sandeman Clark & Co.,* (1902) 1 *Ch.* 579). If the loan is not repaid on demand or on expiry of the time after prior notice is given, the mortgagee can sell the shares and recover the money (*Tucker* v. *Wilson,* (1714) *I. P. Wms.* 261). The danger of taking blank forms of transfer lies in the fact that the borrower may by some fraud obtain duplicate certificates and pledge them twice over with some other lender. In such a case if the other lender gives prior notice to the company of this pledge he obtains priority over the original lender. The other risk is that a good many articles of association of companies contain a clause to the effect that the company itself will have a first and paramount lien over the shares for all that is due to it by the shareholders as we have already seen under the heading of 'lien on shares.' If therefore the borrower as a shareholder of the company concerned owes money to the company as well as to the lender, who, without investigation, happens to advance money on these blank transfers, he may ultimately find that his security is either worthless, or not of much value, owing to the fact that the company has a first and paramount right over the proceeds. It has been held that a foreclosure can be obtained in cases where shares or debentures have been deposited, particularly where they are not transferable by mere delivery as in case of share warrants or bearer debenture bonds (*Harold* v. *Plenty,* (1901) 2 *Ch.* 314; *General Credit Co.* v. *Glegg,* (1883) 22 *Ch. D.* 549). The deposit of a debenture bond amounts to a pledge and not to a mortgage and in such cases, sale would be the proper remedy and not foreclosure (*Cartar* v. *Wake,* (1877) 4 *Ch. D.* 605).

We have seen above how blank transfers from the lender's standpoint are not safe and the usual practice

is, as followed by many banks, *viz.*, to get the shares on which the amount is advanced transferred to the name of the banker, or one of bank nominees, subject to the repayment of the loan . The banker thus secures what is known as a legal as well as equitable right, and thus, the question of the first and paramount lien of the joint stock company concerned does not arise. This can of course be done in cases where the shares are fully paid, as in the case of partly paid shares the lender is confronted with the risk of having to pay calls on these shares which he may not be able to recover from the borrower in case the borrower's financial position becomes unsound.

With reference to blank transfers, as we noticed above, the case in point is *Bradford Bank Co.* v. *Briggs*, (1886) 12 *A. C.* 29 where according to the articles, the company was to have a first and paramount lien over the shares for non-payment of calls, etc., and where a shareholder had mortgaged his shares against a loan by deposit at the bank and the bank has given due notice of such deposit to the company whose shares they were and the shareholders in course of trading with the company thereafter became indebted to the company, it was held that the company having notice of the deposit cannot claim to enforce the lien given by the articles for a debt incurred subsequent to the notice. It was held here that the bank which had given notice of this mortgage was not given a notice of trust, but only sought to effect the company in their capacity of traders with notice of interest of the bank (*See also Mackereth* v. *Wigon Coal and Iron Co.*, (1916) 2 *Ch.* 293).

In the case of forged transfers, if the banker gets same transferred to his name, or that of his nominee, unconscious of this fact, and thereafter, sells the share on failure of the customer, he would be personally liable to the purchaser, as the forged transfer gives no title. The purchaser has also the right to recover damages from the company, on the footing that he relied on the certificate issued by the company to the bank (*Bahia and S. F. Ry.*

Company, (1868) 3 *Q. B.* 584 *at page* 595). Here also in case the company has to pay damages, it would in turn claim same from the bank as indemnity, whereas the banker's claim against his customer would most probably be worthless. In *Hazarimall Shohanlal* v. *Satish Chandra Ghose,* (1919) 46 *Cal.* 331, *Chaudhuri, J.*, held that (a) a *bona fide* purchaser of shares from a person, who is in possession of them by fraud, does not acquire a good title to them and (b) share-certificates passing from hand to hand with blank transfer deeds do not thereby become negotiable instruments.

In Bombay the Appeal Court in *Abdul Vahed Abdul Karim* v. *Husanali Ghasia,* (1926) 28 *Bom. L. R.* 562, laid down that the registered owner of shares by handing over share-certificates with a blank transfer duly signed by him to another person, does not represent to the world that such a person is entitled to deal with the shares and therefore a *bona fide* purchaser from such a person does not acquire a good title to such shares. In this case the English cases, *viz., France* v. *Clark,* (1884) 26 *Ch. D.* 257, and *Fox* v. *Martin,* (1895) 64 *L. J. Ch.* 473, were followed. In *Maneckji Bharucha* v. *Wadilal Sarabhai & Co.,* (1926) 28 *Bom. L. R.* 777, the Privy Council decided however that shares of a company are " goods " within the meaning of Sec. 76 of the Indian Contract Act, 1872. Now they are goods under Sec. 2(7) of the Indian Sale of Goods Act, 1930. In case, therefore, shares are sold with a blank transfer and a cheque is paid by the purchaser in payment thereof, in the event of the said cheque being subsequently dishonoured, the lender can only sue to recover either on the dishonoured cheque or on the original value of shares. He has no lien or claim on the shares as such. As soon as the shares were sold, and share-certificates with the blank transfer were handed over to the buyer, the goods became ascertained goods and the property passed. With respect to the rule of the Bombay Stock Exchange that, in case the cheque paid against purchase of shares is dishonoured, the shares are to be returned to the vendor, or

resold the following day, their Lordships held that the said rule was not intended to make delivery of the share-certificates conditional on payment. The real purpose of the rule according to them was not for the purpose of perfection of the contracts, or the passing of the property, but for estimating promptly the damages resulting from the purchaser's failure to pay for the shares bought and accepted.

Forms of articles of Table A and others on share capital, calls, transfer and transmissions, forfeiture and share warrants

The numbers given against each article are those assigned to each clause in the Table A.

Shares

Table A—Clause 3 :—Subject to the provisions, if any, in that behalf of the memorandum of association of the company, and without prejudice to any special rights previously conferred on the holders of existing shares in the company, any share in the company may be issued with such preferred, deferred or other special rights, or such restrictions, whether in regard to dividend, voting, return of share capital, or otherwise as the company may from time to time by special resolution determine.

NOTE :—In connection with this it may be noted that ordinarily and in practice, it is usual in case of Indian companies to place under the heading "capital and increase and reduction of capital" or under the simple heading of "capital clauses" articles relating to the amount of authorised capital of company and its division into shares, also the conditions under which new shares may be issued and increased, reduced and sub-divided. These clauses are more or less on the following footing :—

Capital and Increase and Reduction of Capital

AMOUNT OF CAPITAL

"The capital of the company shall consist of Rs............... divided into.........shares of Rs.............each.

BOARD'S POWERS AS TO ALLOTMENT

"At present about.........share will be offered for subscription and allotment, the remaining shares being offered, at any

time or times and in such number or numbers and at such price (with an eye to the market price of the day) and for such purpose or purposes as to the board of directors may seem fit in their sole discretion, all the shares (both those now issued and those issued in future) having as to capital, profit sharing, voting and other things equal rights with each other, with power to divide the shares in the whole or part of the capital for the time being into several classes and to attach thereto respectively any preferential, qualified or special rights, privileges or conditions but so that where shares are issued with any special or preferential rights attached thereto, such rights shall not be alterable otherwise than pursuant to the provisions on that behalf of the Articles of Association"

INCREASE OF CAPITAL AND HOW CARRIED INTO EFFECT

"The board of directors may, with the sanction of the company in general meeting (here "by special or extraordinary resolution" may be added if required) from time to time increase the capital of the company to any amount by the creation of new shares, as they may deem expedient. The new shares shall be issued upon such terms and conditions and with such rights and privileges annexed thereto, as the board resolving upon the creation thereof shall direct, and in particular, such shares may be issued with a preferential or qualified right to dividends, and in the distribution of assets of the company, and with a special or without any right of voting and the board resolving upon the creation of the shares may direct that the same or any of them be offered in the first instance to all the then members, in proportion to the amount of the capital held by them, or make any other provisions as to the issue and allotment of the new shares. The company may also exercise any of the powers conferred by Section 50 of the said Act."

NOTE :—

SAME AS ORIGINAL CAPITAL

"Except so far as otherwise provided by the conditions of issue or by these presents, any capital raised by the creation of new shares, shall be considered as part of the initial capital and shall be subject to the provisions herein contained with reference to the payment of calls and instalments, transfer and transmission, forfeiture, lien, surrender, voting and otherwise."

REDUCTION OF CAPITAL

"The company may, from time to time (here "by special or extraordinary resolution" may be added if required) reduce

its capital in any manner for the time being authorised by law, and in particular, capital may be paid off on the footing that it may be called up again or otherwise. This Article is not to derogate from any powers the company would have, if it were omitted."

SUB-DIVISION OR CONSOLIDATION OF SHARES

"The company may, from time to time by (here "by special or extraordinary resolution" may be added if required) special resolution, sub-divide or consolidate its shares or any of them and the special resolution whereby any share is sub-divided or any shares are consolidated, may determine that, as between the holders of the shares resulting on such sub-division or consolidation, one or more of such shares, shall have same preference of special advantage as regards dividend, capital, voting, or otherwise over or as compared with the other or others."

MODIFICATION OF RIGHTS

"Whenever the capital, by reason of the issue of preference shares or otherwise, is divided into different classes of shares, all or any of the rights and privileges attached to the different classes of shares in the capital for the time being of the company, may be modified, commuted, affected or abrogated, by agreement between the company and any person purporting to contract on behalf of that class, provided such agreement is confirmed by an extraordinary resolution passed at a separate general meeting of the holders of the shares of that class, and all the provisions hereinafter contained as to general meeting shall *mutatis mutandis,* apply to every such meeting but so that the quorum thereof shall be members holding or representing in person or by proxy one-fifth of the nominal amount of the issued shares of the class. This article is not to derogate from any powers the company would have if it were omitted."

Frequently separate articles are put under the separate heading such as the following :—

SUB-DIVISION AND CONSOLIDATION OF SHARES

"The company may (here "by special or extraordinary resolution" may be added, if required) sub-divide or by ordinary resolution consolidate its shares or any of them.

"The resolution whereby any share is sub-divided may determine that as between the holders of the shares resulting from such sub-division one or more of such shares shall have some preference or special advantage as regards dividend, capital, voting or otherwise over or as compared with the others or other."

Table A—Clause 4 :—If at any time the share capital is divided into different classes of shares, the rights attached to any class (unless otherwise provided by the terms of issue of the shares of that class) may be varied with the consent in writing of the holders of three-fourths of the issued shares of that class, or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of the shares of the class. To every such separate general meeting the provisions of these regulations relating to general meetings shall *mutatis mutandis* apply, but so that the necessary quorum shall be two persons at least holding or representing by proxy one-third of the issued shares of the class.

Table A—Clause 5 :—No share shall be offered to the public for subscription except upon the terms that the amount payable on application shall be at least five per cent. of the nominal amount of the shares, and the directors shall, as regards any allotment of shares, duly comply with such of the provisions of Sections 101 and 104 of the Indian Companies Act, 1913, as may be applicable thereto.

Table A—Clause 6 :—Every person whose name is entered as a member in the register of members shall, without payment, be entitled to a certificate under the common seal of the company specifying share or shares held by him and the amount paid up thereon; provided that in respect of a share or shares held jointly by several persons, the company shall not be bound to issue more than one certificate and delivery of a certificate for a share to one of several joint-holders shall be sufficient delivery to all.

Table A—Clause 7 :—If a share-certificate is defaced, lost or destroyed, it may be renewed on payment of such fee, if any, not exceeding eight annas, and on such terms, if any, as to evidence and indemnity as the directors think fit.

Table A—Clause 8 :—No part of the funds of the company shall be employed in the purchase of, or in loans upon the security of, the company's shares.

NOTE.—In Indian companies, however, specific clauses are to be found instead of clauses of a general nature as above indicated by the Table A in connection with shares. Thus there is a specific clause, *e.g.*, for the numbering of shares as follows :—

SHARES TO BE NUMBERED PROGRESSIVELY AND NO SHARE TO BE SUB-DIVIDED

"The shares in the capital shall be numbered progressively and except in the manner hereinbefore mentioned no share shall be sub-divided."

Some companies have specific clauses laying down how the applications are to be made and how they are to be dealt with such as the following :—

ACCEPTANCE OF SHARES

"An application for shares in the company, signed by or on behalf of the applicant, and followed by an allotment of any share therein, or the subscribing of the memorandum of association, (prefixed to these articles) and these articles of association specifying the number of shares to be taken, shall, on the registration of the Company, be deemed to be an acceptance of such shares within the meaning of these articles, entitling the company to place the name of the allottee or subscriber on the register in respect thereof, and every person who thus, or otherwise, accepts any shares and whose name is on the register, shall be deemed a member."

MINIMUM SUBSCRIPTION

Frequently a clause is also inserted with a view to declare the minimum subscription under this heading :—

"No allotment shall be made of any share capital of the company unless the amount named in the relevant prospectus as the minimum subscription has been subscribed and the sum payable on application therefore has been paid to and received by the company."

NOTE :—Now under S. 101 of the Amended Act of 1936 no allotment can be made of any share capital unless the amount stated in the prospectus as the minimum amount which must be raised in the opinion of the directors by issue of the shares to provide for various items as provided there is applied for.

SHARES AT THE DISPOSAL OF THE DIRECTORS

"The shares shall be under the control of the directors who may allot or otherwise dispose of the same to such persons on such terms and conditions and at such times as the directors think fit and the allotment of so many of the shares as have not been allotted at the date of the registration of these articles shall exclusively appertain to and be vested in the directors, who shall have the power at their absolute discretion to allot all or any of such shares as fully or in part paid up or otherwise in such manner and at such time and to such person or persons as the directors, in their absolute discretion shall think fit."

The above clause is usually followed by another clause such as the following :—

DIRECTORS MAY ALLOT SHARES AS FULLY PAID UP

"The directors may allot and issue shares in the capital of the company as payment or part payment for any property sold or transferred, goods or machinery supplied or for services rendered to the company in or about the formation or promotion of the company or the conduct of its business; and any shares which may be so allotted may be issued as fully paid up shares, and if so issued shall be deemed to be fully paid up shares."

APPLICATION MONEY

NOTE :—The new Sec. 101 (2B) now makes it compulsory that all the money received from applicants for shares must be deposited with a Scheduled Bank until returned or certificate to commence business is obtained. To remind the management of this requirement of law an article may be added as follows :—

"The directors shall cause all moneys received from applicants for shares to be deposited and kept in a Scheduled Bank as defined in the Reserve Bank of India Act, 1934, until returned in accordance with the provisions of Sec. 101 (4) (*i.e.*, the amount stated in the prospectus as the minimum amount which in the opinion of the directors must be raised by the issue of share capital as minimum subscription) or until a certificate to commence business is obtained to commence business as required by Sec. 103."

With reference to application and allotment constituting an agreement a clause such as the following is to be found :—

ACCEPTANCE OF SHARES

"An application signed by or on behalf of an applicant for shares in the company, followed by an allotment of any share therein, shall be an acceptance of shares within the meaning of these articles and every person who thus or otherwise accepts any shares and whose name is on the register, shall, for the purposes of these articles, be a shareholder."

One separate clause further declares that deposits made on account of application of shares and calls are to be treated as a debt payable immediately. This clause usually runs as follows :—

DEPOSIT TO BE DEBT PAYABLE IMMEDIATELY

"The money (if any) which the directors shall, on the allotment of any shares being made by them, require or direct to be paid by way of deposit, call or otherwise in respect of any share

or shares so allotted by them, shall immediately, on the inscription of the name of the allottee in the register of members as the name of holder of such share or shares, become a debt due to, and recoverable by the company from the allottee thereof, and shall be paid by him accordingly."

A separate clause further fixes the liability of shareholders and their personal representatives in the following terms :—

LIABILITY OF MEMBERS

"Every member or his heirs, executors or administrators or assigns shall pay to the company the proportion of the capital represented by his share or shares, which may, for the time being remain unpaid thereon, in such amounts, at such time or times and in such manner as the directors may, from time to time, in accordance with the company's regulations, require or fix for the payment thereof."

Frequently a clause preventing the directors from advancing or lending money on the shares of the company or the purchase of shares is added. Of course there is no objection in law, to a company formed for money lending purpose to receiving its own shares in deposit as security, but this practice is highly objectionable from the standpoint of efficient organisation. The purchase by a company of its own shares is void, but as a sort of reminder to the management of that fact, this fact is reiterated in the articles. This clause usually runs as follows :—

COMPANY'S SHARES NOT TO BE PURCHASED

"None of the funds of the company shall be employed in the purchase of or loan on shares of the company.

NOTE :—In connection with the above clause it is interesting to note Sec. 54A (2) of the Amending Act of 1936, which prohibits giving of loans, guarantees or security or any financial assistance to any person in connection with the purchase of any shares in the company, except in case of a lending company. This section should be referred to by the draftsman for details.

Frequently a clause is to be found as a reminder with regard to the return of allotment to be filed in proper time. It runs as follows :—

RETURN AS TO ALLOTMENTS TO BE FILED

"As regards all allotment from time to time made, the directors shall duly comply with Section 104 of the Indian Companies Act of 1913."

Frequently an article is inserted with a view to take powers

as authorised by Section 49 which powers can only be exercised if authorised by the articles. These powers are taken with a view to make arrangements on the issue of shares providing for a difference between the shareholders in the amounts and in time of payment of calls on their shares. This clause runs as follows :—

POWER TO ARRANGE FOR DIFFERENT AMOUNTS BEING PAID ON SHARES

"The company may make arrangements on the issue of shares for a difference between the holders of such shares in the amount of calls to be paid and the time of payment of such calls."

A separate clause is also inserted under this heading providing for the payment of under-writing commission. Some companies bring this matter under a separate heading. The clause runs as follows :—

COMMISSION FOR PLACING SHARES

"The company may at any time pay or agree to pay a commission to any person subscribing or agreeing to subscribe (whether absolutely or conditionally) for any shares in the company, but so that if the commission shall be paid or payable out of the capital, the statutory conditions and requirements shall be observed and complied with; and the commission shall not exceed two per cent, on the shares in each case subscribed or agreed to be subscribed."

Another alternative clause runs as follows :—

"The directors may pay or agree to pay a commission on behalf of the company to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares in the company, or procuring or agreeing to procure subscriptions, whether absolute or conditional for any shares in the company; but the amount or rate of such commission shall not exceed five per cent. of the nominal amount of the shares so offered, subscribed or to be subscribed."

The clause providing for the position of joint holders is also to be found in the following form :—

ANY ONE OF JOINT HOLDERS DEEMED SOLE HOLDER

"If any share stands in the names of two or more persons. any one of them shall, as regards receipt of dividends or bonus, service of notice and all or any other matters connected with the company, except voting at meetings and the transfer of shares be deemed the sole holder thereof but the joint-holders of a share shall be severally as well as jointly liable for the payment of all

instalments and calls due in respect of such shares and for all incidents thereof according to the company's regulations."

The principle of law which lays down that notice of trust will not be recognised is also reiterated in most of the Indian companies' articles of association in the following form :—

TRUSTS NOT RECOGNISED

"Save as herein otherwise provided, the company shall be entitled to treat the registered holder of any shares as the absolute owner thereof, and accordingly shall not, except as ordered by a Court of competent jurisdiction, or as by the Act required, be bound to recognise any equitable or other claim to or interest in such share on the part of any other person."

A special clause provides for the contingency of notice being given in case of change of name or address of the shareholders. The clause runs as follows :—

NOTICE OF CHANGE OF NAME OR ADDRESS

"No shareholder, who shall change his name or address or who, being a female, whose marriage shall in law confer on her husband an interest in her property, shall marry, nor the husband of any such last mentioned shareholder, respectively, shall be entitled to recover any dividend or to vote, until notice of the change of name or address or of such marriage has been given to the company."

CERTIFICATE

In connection with the certificate of shares a clause similar to Clause 6 of Table A. as stated above, is to be found in most of our Indian companies with little variation where the managing agency happens to be in management. This clause runs as follows, which can be compared with Clause 6 of the Table A above :—

SHARE CERTIFICATE

"Every member or allottee of share shall be entitled to receive without payment a certificate under the common seal of the company which shall be affixed thereto by the managing agents or some person authorised by them in their behalf in such form as the directors shall prescribe, specifying the share allotted to him and the amount paid thereon and such certificate shall be signed by the managing agents, or by some other person appointed by the directors. Two or more joint allottees of a share shall for the purpose of this article be treated as a single member, and the certificate of any share which may be the subject of joint ownership may be delivered to any one of such joint owners on behalf of all of them."

With reference to Clause 7 of the Table A above in connection with renewal of certificates, the usual wording of a similar clause in the Indian articles of association is as follows :—

RENEWAL OF CERTIFICATE

"If any such certificate be worn out, defaced, destroyed or lost or if there is no further space on the back thereof for the endorsements or transfer it may be renewed or replaced on payment of such sum, not exceeding one rupee, as the directors may from time to time prescribe. Provided however that such new certificate shall not be granted except upon delivery up of the worn out or defaced or used up certificate for the purpose of cancellation and upon proof of destruction or loss to the satisfaction of the directors and on such indemnity as the directors deem adequate in the case of the certificate having been destroyed or lost. Any renewal certificate may be marked as such."

LIEN

Table A—Clause 9 :—The company shall have a lien on every share (not being a fully-paid share) for all moneys whether presently payable or not, called or payable at a fixed time in respect of that share, and the company shall also have a lien on all shares (other than fully-paid shares) standing registered in the name of a single person, for all moneys presently payable by him or his estate to the company; but the directors may at any time declare any share to be wholly or in part exempt from the provisions of this clause. The company's lien, if any, on a share shall extend to all dividends payable thereon.

Table A—Clause 10 :—The company may sell, in such manner as the director thinks fit, any shares on which the company has a lien, but no sale shall be made unless some sum in respect of which the lien exists is presently payable, nor until the expiration of fourteen days after a notice in writing, stating, and demanding payment of such part of amount in respect of which the lien exists as is presently payable, has been given to the registered holder for the time being of the share, or the person entitled by reason of his death or insolvency to the share.

Table A—Clause 11 :—The proceeds of the sale shall be applied in payment of such part of the amount in respect of which the lien exists as is presently payable and the residue shall (subject to a like lien for sums not presently payable as existed upon the shares prior to the sale) be paid to the person entitled to the shares at the date of the sale. The purchaser shall be registered as the holder of the shares, and he shall not be bound to see the application of the purchase money, nor shall his title to the shares

be affected by any irregularity or invalidity in the proceedings in reference to the sale.

The lien clauses in the articles of association of our Indian companies run in a little different form carrying different conditions. They are more or less in the following form :—

COMPANY'S LIEN ON SHARES

"The company shall have a first and paramount lien upon all the shares other than fully paid up shares registered in the name of each member (whether solely or jointly with others) and upon the proceeds of sale thereof, for all his debts, liabilities and engagements solely or jointly with any other person, to or with the company, whether the period for the payment, fulfilment, or discharge thereof shall have actually arrived or not and no equitable interest in any share shall be created except upon the footing and condition that this clause is to have full effect, and such lien shall extend to all dividends and bonuses from time to time declared in respect of such shares. Unless otherwise agreed, the registration of a transfer of shares shall operate as a waiver of the company's lien, if any, on such shares."

An alternative clause may be quoted as follows :—

The company shall have a first and paramount lien upon all shares held by any member of the company (either alone or jointly with other persons) and upon all Dividends and Bonuses which may be declared in respect of such shares for all debts, obligations and liabilities of such members to the company. Provided always that if the company shall register a transfer of any shares upon which it has such a lien as aforesaid without giving to the transferee notice of its claim, the said shares shall be freed and discharged from the lien of the company.

ENFORCING A LIEN BY SALE

"For the purpose of enforcing such lien, the directors may sell the shares subject thereto in such manner as they think fit; but no sale shall be made until such period as aforesaid shall have been arrived, and until notice in writing of the intention to sell, shall have been served on such member, his heirs, executors or administrators, and default shall have been made by him in the payment, fulfilment, or discharge of such debts, liabilities or engagements for seven days after such notice."

An alternative clause may be quoted as follows :—

The Directors may at any time after the date for the payment or satisfaction of such debts, obligations or liabilities shall have arrived, serve upon any member who is indebted or under any obligation to the company, or upon the person entitled

to his shares by reason of the death or bankruptcy of such member, a notice requiring him to pay the amount due to the company or satisfy the said obligations and stating that if payment is not made or the said obligation is not satisfied within a time (not being less than fourteen days) specified in such notice, the shares held by such member will be liable to be sold; and if such member or the person entitled to his shares as aforesaid shall not comply with such notice within the time aforesaid, the directors may sell such shares without further notice.

APPLICATION OF PROCEEDS OF SALE

"The net proceeds of any such sale shall be applied in or towards satisfaction of the said debts, liabilities or engagements, and the residue (if any) paid to such member, his heirs, executors, administrators or assigns."

An alternative clause may be quoted as follows :—

Upon any sale being made by the directors of any shares to satisfy the lien of the company thereon the proceeds shall be applied; first, in the payment of all Costs of such sale, next in satisfaction of the debts or obligations of the member to the company; and the residue (if any) shall be paid to the person entitled to the shares at the date of the sale or as he shall direct.

VALIDITY OF SALE AFTER ENFORCING LIEN

"Upon any sale after enforcing a lien in purported exercise of the powers hereinbefore given, the directors may cause the purchaser's name to be entered in the register in respect of the shares sold and the purchaser shall not be bound to see to the regularity of the proceedings, or to the application of the purchase money, and after his name has been entered in the register in respect of such shares, the validity of the sale shall not be impeached by any person, and the remedy of any person aggrieved by the sale shall be in damages only and against the company exclusively."

CALLS ON SHARES

Table A—Article 12 :—The directors may from time to time make calls upon the members in respect of any moneys unpaid on their shares, provided that no call shall exceed one-fourth of the nominal amount of the share, or be payable at less than one month from the last call; and each member shall (subject to receiving at least fourteen days' notice specifying the time or times of payments) pay to the company at the time or times so specified, the amount called on his shares.

NOTE :—The above form is mostly followed with slight variation as will be seen from the following specimen :—

CALLS

"The Board may, from time to time, but subject to the conditions hereinafter mentioned, make such calls as they think fit upon the shareholders, in respect of all moneys for the time being unpaid on the shares held by them; and every shareholder shall be liable to pay the amount of every call to the person and at the time and place appointed by the Board. A call may be made payable by instalments."

Table A—Clause 13 :—The joint-holders of a share shall be jointly and severally liable to pay all calls in respect thereof.

NOTE :—The above clause has been dealt with under the heading of "SHARES" with specimen of those used by Indian companies.

Table A—Clause 14 :—If a sum called in respect of a share is not paid before or on the day appointed for payment thereof, the person from whom the sum is due shall pay interest upon the sum at the rate of five per cent. per annum from the day appointed for the payment thereof to the time of the actual payment, but the directors shall be at liberty to waive payment of that interest wholly or in part.

Table A—Clause 15 :—The provisions of these regulations as to payment of interest shall apply in the case of non-payment of any sum which, by the terms of issue of a share, becomes payable at a fixed time, whether on account of the amount of the share, or by way of premium, as if the same had become payable by virtue of a call duly made and notified.

Table A—Clause 16 :—The directors may make arrangements on the issue of shares for a difference between the holders in the amount of calls to be paid and in the times of payment.

NOTE :—A similar clause as the *Clause 14* as to payment of interest on failure of call being paid is to be found in most of the Indian companies' articles of association with a little modification as circumstances may warrant. A specimen is given below :—

CALLS TO CARRY INTEREST

"If any shareholder fails to pay any call due from him on the day appointed for payment thereof, or any such extension thereof as aforesaid, he shall be liable to pay interest for the same, from the day appointed for the payment thereof to time of actual payment, at such rate as shall from time to time be fixed by the Board; but nothing in this Article shall be deemed

to make it compulsory upon the Board to demand or recover any interest from any such shareholder."

In some cases the interest is actually provided for in the Article itself as "shall be liable to pay interest for the same at the rate of nine per cent per annum."

An alternative clause may be quoted as follows :—

If the sum payable in respect of any call or any instalment of a call be not paid on or before the day appointed for payment thereof, the holder for the time being of the share in respect of which the call shall have been made or the instalment shall be due, shall be liable to pay interest for the same at such rate not exceeding nine per cent per annum as the directors shall determine from the day appointed for the payment of such call or instalment to the time of actual payment but the directors may if they shall think fit waive the payment of such interest or any part thereof.

With regard to *Clause 16* we have already dealt with this point under the heading of shares. Instead of the clause in the form of Clause 15 of Table A the usual practice with Indian companies is to lay down certain specific clauses, first as to the period of notice of calls, the date on which the call actually falls due and the directors' discretion to extend time for the payment of calls. These clauses are in more or less the following form :—

NOTICE OF CALL

"Eight days' notice, at the least, shall be given by the company (either by letter to the members or by advertisement) of the time and place appointed by the Board for the payment of every call made payable otherwise than on allotment."

CALL TO DATE FROM RESOLUTION

"A call shall be deemed to have been made at the time when the resolution authorizing the call was passed."

DIRECTORS MAY EXTEND TIME

"The directors may, from time to time, at their discretion, extend the time fixed for the payment of any call and may extend such time as to all or any of the shareholders whom, from residence at a distance or other cause of any nature, whatsoever, the directors may deem fairly entitled to such extension save as a matter of grace and favour."

NOTE :—Some articles emphasise that "no shareholder shall be entitled to any such extension as a matter of right."

There is a further clause providing for certain facts as having been proved through certain entries in the register of members, etc., such as the following :—

EVIDENCE IN ACTION FOR CALL

"On the trial or hearing of any action for the recovery of any money due for any call, it shall be sufficient to prove that the name of the member sued is entered in the register as the holder, or one of the holders, of the shares in respect of which such debt is accrued; that the resolution making the call is duly recorded in the minute book; and that notice of such call was duly given to the members sued in pursuance of these presents; and it shall not be necessary to prove the appointment of the directors who made such call, nor any other matters whatsoever, but the proof of the matters aforesaid shall be conclusive evidence of the debt."

CALLS IN ADVANCE

Table A—Clause 17 :—The directors may, if they think fit, receive from any member willing to advance the same all or any part of the moneys uncalled and unpaid upon any shares held by him; and upon all or any of the moneys so advanced may (until the same would, but for such advance become presently payable) pay interest at such rate (not exceeding, without the sanction of the company in general meeting, six per cent) as may be agreed upon between the member paying the sum in advance and the directors.

NOTE :—A specimen form usually used by Indian companies and more suitable to Indian conditions is as follows :—

PAYMENT OF CALLS IN ADVANCE

"The board may, if they think fit, receive from any of the shareholders willing to advance the same, all or any part of the amounts of their respective shares beyond the sum actually called up, and upon the moneys so paid in advance, or upon so much thereof, from time to time, and at any time thereafter, as exceeds the amount of the calls then made upon and due in respect of the shares on account of which such advances are made, the board may pay or allow interest, at such rate as the shareholder paying the sum in advance and the board agree upon.

TRANSFER AND TRANSMISSION OF SHARES

Generally speaking most of the Indian companies start this heading with a clause providing for a book called "register of transfers" being kept. This clause runs as follows :—

"The company shall keep a book to be called the "register of transfers" and therein shall be fairly and distinctly entered the particulars of every transfer or transmission of every share."

This reminds the management of their duty to maintain in

the interest of efficient organization and record this most necessary book.

Table A—Clause 18 :—The instrument of transfer of any share in the company shall be executed both by the transferrer and transferee, and the transferrer shall be deemed to remain holder of the share until the name of the transferee is entered in the register of members in respect thereof.

Table A—Clause 19 :—Shares in the company shall be transferred in the following form, or in any usual or common form which the directors shall approve :—

I, AB of , in consideration of the sum of rupees paid to me by CD of (hereinafter called "the said transferee"), do hereby transfer to the said transferee the share (or shares) numbered in the undertaking called the Company, Limited, to hold unto the said transferee, his executors, administrators and assigns, subject to the several conditions on which I held the same at the time of the execution thereof, and I, the said transferee do hereby agree to take the said share (or shares) subject to the conditions aforesaid. As witness our hands the day of

Witness to the signature of, etc..............

NOTE :—A clause similar to *Clause 18* above is not to be found in most of our Indian companies' articles. With reference to clause 19, a similar clause and form is to be found in every Indian joint stock company's articles of association. The wording generally is that this form or any other form as near thereto as circumstances will permit, should be used.

APPLICATION FOR TRANSFER

NOTE :—In view of the fact that Section 34(1) now specifically lays down the steps to be taken in connection with the application for registration of transfer of shares in a company made by either the transferrer or the transferee and imposes various obligations on the board of directors, it would not be out of place to insert in the articles of association a clause clearly specifying the steps to be taken in this connection. With this view the author suggests a clause more or less in the following terms :—

"*Where the application for the registration of the transfer of shares is lodged with the company by the transferrer of shares which are partly paid, a notice shall be given by the company of the said application to the transferee and if no objection is made by the transferee within two weeks from the date*

> *of the receipt of the said notice, the company shall enter in its register of members the name of the transferee in the same manner and subject to the same conditions as if the application for registration was made by the transferee. For the purpose of this clause, notice to the transferee shall be deemed to have been duly given if despatched by pre-paid post to the transferee at the address given in the instrument of transfer and shall be deemed to have been delivered in the ordinary course of post."*

Table A—Clause 20 :—The directors may decline to register any transfer of shares, not being fully-paid shares, to a person of whom they do not approve, and may also decline to register any transfer of shares on which the company has a lien. The directors may also suspend the registration of transfer during the fourteen days immediately preceding the ordinary general meeting in each year. The directors may decline to recognize any instrument of transfer unless :—

(*a*) a fee not exceeding two rupees is paid to the company in respect thereof; and

(*b*) the instrument of transfer is accompanied by the certificate of the shares to which it relates, and such other evidence as the directors may reasonably require to show the right of the transferrer to make the transfer.

If the directors refuse to register a transfer of any shares they shall within two months after the date on which the transfer was lodged with the company send to the transferee and the transferrer notice of the refusal.

NOTE :—Similar clauses are there in Indian companies' articles of association, but generally a reservation made or suggested in the above clause of Table A, by which fully paid shares are excluded from refusal, is omitted and complete power to refuse is generally taken irrespective of shares being fully or partly paid. One of the forms generally used is as follows :—

DIRECTORS MAY DECLINE TO REGISTER TRANSFER

"The directors may decline to register any transfer of shares in any case in which the company has a lien upon the shares or any of them or whilst any shareholder, executing the same is either alone, or jointly with any other person, indebted to the company, on any account whatsoever, or unless the transferee is approved by the directors. The directors shall in no case be bound to give or assign any reason for their refusal to register

or allow any transfer and the directors' power, at their own discretion, to refuse any transfer, shall not be affected by the fact of the proposed transferee being already a registered shareholder of the company.

Where the registration of the transfer of any shares or debentures is refused as aforesaid, the company shall send to the transferee and the transferrer notice of the refusal within two months from the date on which the instrument of transfer was lodged with the company.

NOTE :—It should be noted here that this is compulsory under Section 34(4) and any default in compliance with the requirements of this section entails a fine not exceeding rupees fifty for every day of default on every director, manager, secretary or other officer of the company who is knowingly a party to the default. It would thus be best to add this paragraph to the above clause in the articles to draw the attention of the management to same. It may be added here that the above procedure has been introduced under the new Act with a view to lay down a procedure which would avoid delays against which there were many complaints formerly.

The other forms to be found in addition to those in Table A are those with regard to closing of transfer books and in some cases prohibition against foreigners holding shares. They are as follows :—

WHEN TRANSFER BOOKS AND REGISTERS MAY BE CLOSED

"The transfer books and register of members may be closed during such time as the directors think fit, not exceeding in the whole 30 days in each year."

PROHIBITION AGAINST FOREIGNER

"If any member being a foreigner is prohibited by law for the time being in force from holding the shares of the company such member or the person in whom such shares become vested by operation of law may, subject to the regulations as to transfer hereinbefore contained, transfer such shares."

EXECUTORS AND ADMINISTRATORS

Table A—Clause 21 :—The executors or administrators of a deceased sole holder of a share shall be the only persons recognized by the company as having any title to the share. In the case of a share registered in the names of two or more holders, the survivor or survivors or the executors or administrators of the

deceased survivor, shall be the only persons recognized by the company as having any title to the share.

Alternative clause to be found in articles of our companies :—

The executors or administrators of a deceased member (not being one of several joint-holders) shall be the only persons recognized by the company as having any title to the share or shares registered in the name of such member unless the directors in their absolute discretion resolve to recognize and give effect to the title of any other person proved to their satisfaction to be entitled to such share or shares upon a sufficient indemnity being given to the company.

In case of the death of any one or more of the joint registered holders of any share or shares, the survivor or survivors shall be the only person or persons recognized by the company as having any title to or interest in such share or shares. Nothing herein contained however shall affect the lien of the company upon any such share or shares or shall release the estate of any deceased member or joint-holder from any liability whatsoever to the company.

Table A—Clause 22 :—Any person becoming entitled to a share in consequence of the death or insolvency of a member shall, upon such evidence being produced as may from time to time be required by the directors, have the right either to be registered as a member in respect of the share or, instead of being registered himself to make such transfer of share as the deceased or insolvent person could have made; but the directors shall in either case, have the same right to decline or suspend registration as they would have had in the case of a transfer of the share by the deceased or insolvent person before the death or insolvency.

An alternative clause to the above as found in the articles of Indian companies is as follows :—

Any person becoming entitled to, or interested in, a share in consequence of the death, bankruptcy, or insolvency of any member, or the marriage of any female member, may, upon producing such evidence as the board think sufficient, either be registered himself as the holder of the share, or at his election have some person nominated by him, and approved by the board, registered as a holder thereof.

Another alternative clause on the same point is as follows :—

Any person becoming entitled to shares in consequence of the death or bankruptcy of any member upon producing such evidence as may from time to time be required by the directors that he sustains the character in respect of which he proposes to act under this clause or of his title, may with the consent of the directors (which they shall not be under any obligation to give)

be registered as a member in respect of such shares, or may, subject to the regulations as to transfers hereinbefore contained, transfer such shares as the deceased or the bankrupt person could have made. This clause is hereinafter referred to as "The Transmission Clause."

Table A—Clause 23 :—A person becoming entitled to a share by reason of the death or insolvency of the holder shall be entitled to the same dividends and other advantages to which he would be entitled if he were the registered holder of the share, except that he shall not, before being registered as a member in respect of the share, be entitled in respect of it to exercise any right conferred by membership in relation to meetings of the company.

NOTE :—Clauses similar to the above are to be found in the Indian companies' articles more or less in the same form or with few variations here and there. We have already seen clauses similar to Clause 21 above of Table A in the forms considered above.

FORFEITURE OF SHARES

Table A—Clause 24 :—If a member fails to pay any call or instalment of a call on the day appointed for payment thereof, the directors may, at any time thereafter during such time as any part of such call or instalment remains unpaid, serve a notice on him requiring payment of so much of the call or instalment as is unpaid, together with any interest which may have accrued.

An alternative clause to the above as found in articles of Indian companies is as follows :—

If any member fails to pay any money due from him in respect of any shares either by way of principal or of interest, on the appointed day, or any such extension thereof as aforesaid, the board may at any time thereafter, during such time as such money remains unpaid, give notice by letter to him or his legal personal representatives, or, if his or their address be unknown, or if he be dead and there be no legal personal representatives of his, then notice by way of advertisement, requiring payment of the money due in respect of such share.

Table A—Clause 25 :—The notice shall name a further day (not earlier than the expiration of fourteen days, from the date of the notice) on or before which the payment required by the notice is to be made, and shall state that, in the case of non-payment at or before the time appointed, the shares in respect of which the call was made will be liable to be forfeited.

An alternative to the above :—

The notice shall name a day (not being less than fourteen

days from the date of the notice) and a place or places on and at which the money is to be paid; and the notice shall also state that, in the event of the non-payment of such money at the time and place appointed, the shares, in respect of which the same is owing, will be liable to be forfeited.

Table A—Clause 26 :—If the requirements of any such notice as aforesaid are not complied with, any share in respect of which the notice has been given may at any time thereafter, before the payment required by the notice has been made, be forfeited by a resolution of the directors to that effect.

An alternative clause of the above is as follows :—

If the requisitions of any such notice as aforesaid, are not complied with, any shares in respect of which such notice has been given may, at any time thereafter, before payment of all calls or instalments, interest and expenses, due in respect thereof, be forfeited by a resolution of the directors to that effect. Such forfeiture shall include all dividends declared in respect of the forfeited shares, and not actually paid before the forfeiture.

Table A—Clause 27 :—A forfeited share may be sold or otherwise disposed of on such terms and in such manner as the directors think fit, and at any time before a sale or disposition the forfeiture may be cancelled on such terms as the directors think fit.

An alternative clause of the above is as follows :—

Every share, which shall be so declared forfeited, shall thereupon become the property of the company, and may be sold, re-allotted, or otherwise disposed of either to the original holder thereof, or to any other person, upon such terms and in such manner as the board shall think fit.

Table A—Clause 28 :—A person whose shares have been forfeited shall cease to be a member in respect of the forfeited shares, but shall, notwithstanding, remain liable to pay to the company all moneys which, at the date of forfeiture, were presently payable by him to the company in respect of the shares, but his liability shall cease if and when the company receives payment in full of the nominal amount of the shares.

An alternative to the above is as follows :—

Any member, whose shares may be forfeited, and every person entitled to such shares, shall, notwithstanding the forfeiture, be liable to pay to the company all moneys owing upon the shares at the time of forfeiture, and the interest (if any) thereon accrued and to accrue up to the time of payment thereof.

EFFECT OF FORFEITURE

The following additional clause is to be found in the articles of association on the same matter :—

The forfeiture of a share shall involve the extinction, at the time of the forfeiture, of all interest, on all claims and demands against the company in respect of the share forfeited, and all other rights incident to such share, except only such of those rights as by these presents are expressly saved.

NOTE :—Clauses similar to 24, 25 and 26 of Table A are universally in use. Frequently a clause is added in some company's articles of association to the effect that the entry of forfeiture with the date thereof shall be forthwith made in the register of members. It runs as follows :—

NOTICE OF FORFEITURE TO SHAREHOLDER

"When any share is so declared to be forfeited, notice of the forfeiture shall be given in the same manner as is provided by Clause 24 of Table A and an entry of the forfeiture, with the date thereof, shall forthwith be made in the register of members."

With regard to forfeited shares being sold, clauses similar to Table A Clause 27 are used in India freely. Clause 28 is also universally adopted with little alterations.

In addition a further clause is to be found usually in the articles of our Indian companies by which power is given to the directors to remit forfeiture under certain conditions. This clause runs as follows :—

FORFEITURE MAY BE REMITTED; ARREARS RECOVERABLE NOTWITHSTANDING FORFEITURE

"In the meantime, and until any share so forfeited shall be sold, re-allotted, or otherwise dealt with as aforesaid, the forfeiture thereof may at the discretion and by a resolution of the directors, be remitted as a matter of grace and favour, and not as of right, on payment to the company of the money which was owing thereon to the company at the time of forfeiture thereof, being declared, with interest for the same up to the time of the actual payment thereof, if the directors shall think fit to receive the same, or on any other terms which the directors may deem reasonable; but notwithstanding such forfeiture, and any subsequent dealing by or on behalf of the company with the shares, which may be the subject thereof, the money which was so owing shall continue to be payable by the person who was liable to pay the same at the time of forfeiture, or his representatives, and may be recovered from him or them by the company accordingly by action, suit, or otherwise, without entitling such person or his representatives to any remission of such forfeiture, or compensation, for the same, unless the directors shall think fit to make

compensation, which they shall have full powers to do in such manner and on such terms on behalf of the company as they shall think fit."

Table A—Clause 29 :—A duly verified declaration in writing that the declarant is a director of the company, and that a share in the company has been duly forfeited on a date stated in the declaration, shall be conclusive evidence of the facts therein stated as against all persons claiming to be entitled to the share, and that declaration, and the receipt of the company for the consideration, if any, given for the share on the sale or disposition thereof, shall constitute a good title to the share, and the person to whom the share is sold or disposed of shall be registered as the holder of the share and shall not be bound to see to the application of the purchase-money (if any), nor shall his title to the share be affected by any irregularity or invalidity in the proceeding in reference to the forfeiture, sale or disposal of the share.

NOTE :—Instead of the above the following clause is usually inserted in Indian companies :—

CERTIFICATE OF FORFEITURE

"A certificate in writing, under the hands and seals of any two directors, and countersigned by the Secretaries, Treasurers and Agents, that the call in respect of a share was made, and that the notice specified in Clauses 24 and 25 of Table A was given, and not complied with, and that the forfeiture of the share was made by a resolution of the directors to that effect, shall be sufficient evidence of the facts stated therein as against all persons entitled to such share; and such declaration, and the receipt of the company for the price of such share, shall constitute a good title to such share; and a certificate, such as is specified in Clause......of...... shall be delivered to the purchaser, and thereupon he shall be deemed the holder of such share, discharged from all calls due prior to such purchase, and he shall not be bound to see to the application of the purchase-money, nor shall his title to the share be affected by any irregularity in the proceedings in reference to such forfeiture or sale."

Table A—Clause 30 :—The provisions of these regulations as to forfeiture shall apply in the case of non-payment of any sum which, by the terms of issue of a share, becomes payable at a fixed time, whether on account of the amount of share, or by way of premium, as if the same had been payable by virtue of a call duly made and notified.

NOTE :—The above clause is not usually adopted but mostly dropped.

Frequently a clause empowering surrender is added under this heading which runs as follows :—

SURRENDER OF SHARES

"The directors may at any time accept the surrender of any share from or by any members desirous of surrendering on such terms as the directors may think fit."

CONVERSION OF SHARES INTO STOCK

Table A—Clause 31 :—The directors may, with the sanction of the company previously given in general meeting, convert any paid-up shares into stock and may with the like sanction reconvert any stock into paid-up shares of any denomination.

Table A—Clause 32 :—The holders of stock may transfer the same, or any part thereof, in the same manner, and subject to the same regulations, as and subject to which, the shares from which the stock arose might previously to conversion have been transferred, or as near thereto as circumstances admit; but the directors may from time to time fix the minimum amount of stock transferable, and restrict or forbid the transfer of fractions of that minimum; but the minimum shall not exceed the nominal amount of the shares from which the stock arose.

Table A—Clause 33 :—The holders of stock shall, according to the amount of the stock held by them, have the same rights, privileges and advantages as regards dividends, voting at meetings of the company, and other matters as if they held the shares from which the stock arose, but no such privilege or advantage (except participation in the dividends and profits of the company) shall be conferred by any such aliquot part of stock as would not, if existing in shares, have conferred that privilege or advantage.

Table A—Clause 34 :—Such of the regulations of the company (other than those relating to share-warrants), as are applicable to paid-up shares shall apply to stock, and the words "share" and "shareholder" therein include "stock" and "stockholder."

NOTE :—In India stocks are not at all popular and shares are universal. Thus these clauses seldom appear in the articles of association of joint stock companies. However in a few companies which have made special provision for it, similar points as covered by the above clauses of the Table A are generally covered by one or two clauses. They run more or less on the following lines :—

SHARES MAY BE CONVERTED INTO STOCK

"The directors may, with the sanction of a general meeting, convert any paid-up share into stock and when any shares shall

have been converted into stock, the several holders of such stock thenceforth transfer their respective interest therein, or any part of such interest, in the same manner and subject to the same regulations as, and subject to which, shares may be or might have been transferred, if no such conversion had taken place, or as near thereto as circumstances will admit.

RIGHTS OF STOCK-HOLDERS

"The stock shall confer on the holders thereof respectively the same privileges and advantages as regards participation in profits and voting at meetings of the company and for other purposes, as would have been conferred by shares of equal amount in the capital of the company, but so that none of such privileges or advantages except the participation in profits of the company, shall be conferred by any such aliquot part of consolidated stock as would not, if existing shares, have conferred such privileges or advantages. And save as aforesaid, all the provisions herein contained, shall, so far as circumstances will admit, apply to stock as well as to shares. No such conversion shall affect or prejudice any preference or other special privileges. The company may at any time reconvert any stock into paid-up shares of any denomination."

SHARE-WARRANTS

Table A—Clause 35 :—The company may issue share-warrants, and accordingly the directors may in their discretion, with respect to any share which is fully paid up, on application in writing signed by the person registered as holder of the share, and authenticated by such evidence (if any) as the directors may from time to time require as to the identity of the person signing the request, and on receiving the certificate (if any) of the share, and the amount of the stamp-duty on the warrant and such fee as the directors may from time to time require, issue under the company's seal a warrant, duly stamped, stating that the bearer of warrant is entitled to the shares therein specified, and may provide by coupons or otherwise for the payment of dividends, or other moneys, on the shares included in the warrant.

Table A—Clause 36 :—A share-warrant shall entitle the bearer to the shares included in it, and the share shall be transferred by the delivery of the share-warrant, and the provisions of the regulations of the company with respect to transfer and transmission of shares shall not apply thereto.

Table A—Clause 37 :—The bearer of a share-warrant shall, on surrender of the warrant to the company for cancellation, and on payment of such sum as the directors may from time to time

prescribe be entitled to have his name entered as a member in the register of members in respect of the shares included in the warrant.

Table A—Clause 38 :—The bearer of a share-warrant may at any time deposit the warrant at the office of the company, and so long as the warrant remains so deposited, the depositor shall have the same right of signing a requisition for calling a meeting of the company, and attending and voting and exercising the other privileges of a member at any meeting held after the expiration of two clear days from the time of deposit, as if his name were inserted in the register of members as the holder of the shares included in the deposited warrant. Not more than one person shall be recognised as depositor of the share-warrant. The company shall, on two days' written notice, return the deposited share-warrant to the depositor.

Table A—Clause 39 :—Subject as herein otherwise expressly provided, no person shall as bearer of a share-warrant, sign a requisition for calling a meeting of the company or attend or vote or exercise any other privilege of a member at a meeting of the company, or be entitled to receive any notices from the company; but the bearer of a share-warrant shall be entitled in all other respects to the same privileges and advantages as if he were named in the register of members as the holder of the shares included in the warrant, and he shall be a member of the company.

Table A—Clause 40 :—The directors may, from time to time, make rules as to the terms on which (if they shall think fit) a new share-warrant or coupon may be issued by way of renewal in case of defacement, loss or destruction.

NOTE :—Share-warrants are usually discouraged in India by companies and hence one seldom comes across Indian articles on that point.

CHAPTER X.

The Directors

Definition

A joint stock company usually carries on business through the medium of "directors" who control the company's management. The actual management is generally vested in a special officer called the "manager" and when that officer also happens to be a director, he is known as the "managing director." The Indian Companies Act defines the director as including "any person occupying the position of a director by whatever name called" (Sec. 25). Thus function is everything, name matters nothing (*In Re. Forest of Dean Coal Mining Co.*, (1878) 10 *Ch. D.* 450).

THEIR APPOINTMENT AND QUALIFICATIONS

According to the Indian Companies Amending Act of 1936, every company *shall have at least three directors* (*S. 83A*). *This section does not apply to a private company, except a private company being a subsidiary company of a public company.* In default, subject to any regulations in the articles of the company, subscribers to the memorandum of association are *de facto* directors until the first directors are appointed [Sec. 83 B (1)]. The directors here shall be appointed by members in general meeting. Here if the subscribers to the memorandum fail to call a meeting *any member, entitled to vote may apply to the Court to call a meeting under S. 79* (*3*) with a view to get the directors elected. This regulation is not applicable to a private company. It is, however, the practice in case of all joint stock companies whether in India, or in England, public or private, to appoint a board made up of men of position and experience to act as directors. The first directors are generally appointed by

the promoters and it is not unusual to find a promoter appointing himself as a director. Usually the current practice is to name the original directors in the articles which has now become universal because it is so convenient and saves an amount of unnecessary trouble and expense. It should be followed in case of every modern company. If that is not done, the first members or subscribers to the memorandum of association act as directors until a meeting of shareholders appoints directors. Of course, the directors may be known by any name, or title, or designation, so long as they occupy the position of director [Sec. 2 (5)] and a limited company may act as directors of another company (*Bulawayo Market Co.*, (1907) 2 *Ch.* 458). In case where the directors are appointed for a specific time and continue to act after that time expires, because no others are appointed to take their place, their act will bind the company (*Muir* v. *Foreman's Trustees*, (1904) *Court of Sss.* 5 *F*, 546). Generally where the appointment is not made through the articles, the appointment has to be made by the shareholders. In such a case the directors cannot authorise an outsider by an agreement or otherwise to nominate a director (*James* v. *Eve*, (1873) *L. R.* 6, *H. L.* 335). If, however, the articles permit such delegation of power for appointing directors to third parties, the Court will recognise the right, though the nomination would not necessarily amount to an appointment of directors because it is open to the Court to refuse to grant specific performance of the agreement (*British Murac Syndicate* v. *Alperton Rubber Co.*, (1915) 2 *Ch.* 186; *Plantations Trust* v. *Bila* (*Sumatra*) *Rubber Lands*, (1916) 85 *L. J. Ch.* 801).

The subsequent directors are appointed by members in general meeting, but in case any casual vacancy occurs during the interval, it shall be filled in by the board of directors itself. There is no objection, however, for articles of association to provide that the signatories to the memorandum shall appoint the first directors, or, it may be arranged by the articles that a meeting of subscribers

may appoint directors by a majority, in which case this meeting should be held subsequent to the registration of the company (*London and Southern Countries Land Company*, (1886) 31 *Ch. D.* 223). It may be noted that according to S. 83 B (2) of the Amendment Act of 1936 *notwithstanding anything contained in the articles of a company other than a private company not less than two-thirds of the whole number of directors shall be persons whose period of office is liable to determination at any time by retirement of directors in rotation. This provision shall not apply to a company incorporated before the commencement of the Indian Companies (Amendment) Act,* 1936 *where by virtue of the articles of the company the number of directors whose period of office is liable to determination at any time by retirement of directors in rotation, falls below the two-thirds proportion mentioned in this section.*

The object of this addition was to provide for not more than one-third of the total number of directors being nominated or appointed by managing agents. As it was thought doubtful later whether this Section 83B (2) would achieve that objective, a further section was added, *viz.*, Section 87 (*i*) which clearly lays down that *notwithstanding anything contained in the articles of a company other than a private company the directors, if any, appointed by the managing agents shall not exceed in number one-third of the whole number of directors.*

There are cases where the articles give power to vendors to appoint one or more directors and in this case the company cannot deprive the vendors of their power by altering the articles. This is because here an attempt is made to break an agreement through alteration of the articles which the Courts do not allow (*British Murac Syndicate Limited* v. *Alperton Rubber Co., Ltd.,* (1915) 2 *Ch. D.* 186). The Court further held in this case that the contract was not incapable of being specifically enforced and that a declaration ought to be made that the two persons nominated by the vendors became and were directors of the defendant company as they were directors under

the proper regulations of a company under the contract. The agreement must not be outside the articles but an agreement with a company to appoint directors and accepted by the articles, otherwise it will not be enforced (*Plantations Trust* v. *Bila* (*Sumatra*) *Rubber Lands*, (1916) 85 *L. J. Ch.* 801). In case of additional directors if the articles specifically give powers to the directors to appoint them the general meeting shall have no power to do so (*Blair Open Hearth Furnace* v. *Reigart*, (1913) 108 *L. T.* 665). However, if the directors do not appoint or are unable to agree on the appointment, the company can appoint the directors (*Barron* v. *Potter*, (1914) 1 *Ch.* 895; *Isaacs* v. *Chapman*, (1916) *W. N.* 28; *Foster* v. *Foster*, (1916) 1 *Ch.* 532).

Casual vacancy includes any vacancy other than one caused by an effluxion of time or retirement by rotation (*Munster* v. *Cammell Co.*, (1882) 21 *Ch. D.* 187; *York Tramways* v. *Willows*, (1882) 8 *Q. B. D.* 685 *at page* 694). There are cases where the articles provide that a specific notice has to be given so many days prior to the "day of election." Under these circumstances if the meeting is adjourned, the date of such adjourned meeting is the date of election (*Catesby* v. *Burnett*, (1916) 2 *Ch.* 325). In connection with the resignation of directors if the articles do not lay down any particular or specific rule and if there is no separate agreement in one form or other fixing the duration, they could resign by a declaration either oral or in writing. If however the articles prescribe that a notice in writing must be given by directors if they resign and if a director offers to resign orally, the company can insist on written resignation. In one case where such an article existed and the director offered to resign orally instead of in writing and the offer was accepted the Court held that in spite of written notice not being given, the resignation was complete here because it was accepted by mutual consent and thus the contract contained in the article was got over by mutual consent (*Latchford Premier Cinema, Ltd.* v. *Ermion*, (1931) *W. N.* 204).

Additional and Alternate Directors

Where the articles delegate to the board of directors the power to appoint additional directors, the general meeting has no power to do this (*Blair Open Hearth Furnace,* (1913) 108 *L. T.* 665), but if the directors cannot agree or are unable to appoint, the company has the power to appoint new directors (*Barron* v. *Potter,* (1914) 1 *Ch.* 895; *Isaacs* v. *Chapman,* (1916) *W. N.* 28; *Foster* v. *Foster,* (1916) 1 *Ch.* 532). In one case where the articles laid down that "until otherwise determined by a general meeting the number of director shall not be less than two nor more than seven," and also adopted clauses 83 and 85 of Table A corresponding to Indian clauses 99 and 101 it was held that the power of appointing additional directors had not been delegated to the directors so as to exclude the inherent power of the company in general meeting to appoint directors (*Worcester Corsetry Ltd.* v. *Witting,* (1936) 1 *Ch.* 640). Where the articles provided that "until otherwise determined by a general meeting the number of directors shall not be less than five nor more than nine" it was held that the resolution at a general meeting of the shareholders to increase the directors to sixteen was valid and no special resolution was required therefore (*Gurprasad Kapoor* v. *Rameshwar Prasad,* (1933) 55 *All.* 399). They also provide for the appointment of what are known as alternate directors to act in place of those who are likely to be frequently abroad. There are some cases, though very rare, where the articles provide for a period for which only the directors are to hold office and thereafter they provide for the election of fresh directors. Here it is also frequently provided that a director is not qualified to be elected as such unless written notice of the intention of his election is given before the day of election. Once such a notice is given to the general body of shareholders who are to elect new directors, it does not make any difference whether the notice contains more names than there are vacancies or less (*Catesby* v. *Burnett,* (1916) 2 *Ch.* 325). Here it was

decided that where such a notice was to be given before the day of election, the notice may be given either before the day of the first meeting, or before the day of the adjourned meeting where the election is being considered.

The practice of assigning office by directors under powers given to them in the articles of association became most frequent in England with the result that the matter came up before the Greene Commission of 1925-26. The Commission in its report stated that " it may be questioned whether such a provision is lawful, at any rate in the case of directors, but in any case we consider that the practice is a most undesirable one and that any such assignment should be prohibited unless it is sanctioned by the company." It further added that " when such a provision is in force the company is deprived of all effective control over its directors and the holder of office is in a position to force upon the company for his own profit any person, whether suitable or not who is willing to pay a price." Accordingly a section prohibiting this practice has been inserted in the English Companies Act of 1929 following which our Indian Companies (Amendment) Act of 1936 lays down that *in case of any company a provision is made by the articles or by any agreement entered into between any person and the company for empowering a director or manager of a company to assign his office as such to another person, any assignment of office made in pursuance of the said provision shall notwithstanding anything to the contrary contained in the said provision be of no effect unless and until it is approved by a special resolution of the company* " (Sec. 86B).

However the exercise by a director of a power to appoint an alternate or substitute director to act for him *during an absence of not less than three months from the district in which meetings of the directors are ordinarily held, if done with the approval of the board of directors, shall not be deemed to be an assignment of office within the meaning of this section.* Of course any such alternate or substitute director shall *ipso facto* vacate office if and

when the appointer returns to the district in which the meetings of the directors are ordinarily held. It will be thus seen that temporary appointments of alternate or substitute directors do not constitute an assignment of office within the meaning of this section, when made with the approval of the board of directors.

Debenture Directors

There are also cases where debenture holders or some other outside body are empowered to attend or nominate directors and in such cases the nomination of such body will in itself be sufficient and no further act on the part of the company will be necessary (*British Murac Syndicate* v. *Alperton Rubber Co.,* (1915) 2 *Ch.* 186). If however the arrangement is that this outside body is to nominate and the company is to appoint them, of course the appointment by the company would be necessary (*Plantations Trust* v. *Bila* (*Sumatra*) *Rubber Lands,* (1916) 85 *L. J. Ch.* 801).

Directors' Qualification

It is further laid down that a person shall not be capable of being appointed a director of a company by the articles, and shall not be named as a director, or proposed director of a company in the prospectus issued by or on behalf of the company, unless the said director has, before the registration of the articles, or publication of the prospectus, or filing a statement in lieu of the prospectus, (1) signed and filed with the registrar a consent in writing to act as such a director; and (2) except in case of a company limited by guarantee not having a share capital, has either signed the memorandum and signed and filed with the registrar a contract in writing to take shares and pay for them for no less than the amount of his qualification, if such a qualification is provided for by the articles. This of course does not apply to a private limited company. From this it should not be thought that it is compulsory under the Companies Act for a director to hold qualification shares. All that the law says is that where the articles

require the director to hold qualification shares he must do so and the construction and wording of the article concerned will decide the question as to when and how he should hold them (*In re. Peoples Bank of Northern India Ltd.*, (1932) *I. R. Lah.* 685). *The Act also requires a notice of change among directors to be given within 14 days from the date of the occurrence* [*Sec. 87* (*2*)]. In this connection it has been laid down in *Lakshmana Mudaliar*, (1932) *A. I. R. Mad.* 497 that this provision which also occurs in footnote of form 26, Appendix A of the Act is not mandatory and no offence is therefore committed by a company by not filing such notice. The director may provide for his qualification share by a joint holding unless the articles provide for a sole holding (*Dunster's Case, Re. Glory Paper Mills*, (1894) 3 *Ch.* 478). These qualification shares may be acquired either from the company or purchased from outside (*Carling's Case*, (1876) 1 *Ch. D.* 115). If the director holds shares as an executor it will be a good qualification unless the articles provide that the share shall be held by him " in his own right " (*Grundy* v. *Briggs*, (1910) 1 *Ch.* 444). It is further laid down that a director cannot accept his qualification shares as a present from the promoters, or vendors, and in case he does so, he shall be liable to make good the whole amount in respect of such shares as a contributory, in case liquidation intervenes (*Hay's Case*, (1875) 10 *Ch. D.* 593). This however will suffice as far as his share qualification as a director is concerned (*Hercynia Copper Co.*, (1894) 2 *Ch.* 403). In fact this conduct amounts to a gross breach of trust, as here the director is virtually speaking accepting a retaining fee from the promoter or vendor and is liable to be sued by the company for damages. The articles frequently lay down that these qualification shares must be held by the directors " in their own rights," which will not mean that they must be beneficially entitled to them (*Pulbrook* v. *Richmond Consolidated Mining Co.*, (1878) 9 *Ch. D.* 610). All that is required is that they should be so held as to be capable of being safely dealt with as far

as the company is concerned (*Bainbridge* v. *Smith,* (1889) 41 *Ch. D.* 462). In one case a managing director whose agreement turned out to be void on other grounds and who failed to take up and pay for qualification shares within time appointed was held to be entitled to his remuneration *quantum meruit.* It was here pointed out that the obligation to pay reasonable remuneration for work done when there is no binding contract is imposed by a rule of law and not by any inference of fact from acceptance of the service (*Craven-Ellis* v. *Cannons Ltd.,* (1936) 2 *K. B.* 403). Again, much depends upon the language of the articles reserving such a provision, because in case the articles make the acquisition of qualification shares a condition precedent to a director taking up his appointment, then the director cannot act unless he acquires the said shares first. If, however, he does not acquire these shares within two months, or any shorter time that may be provided for in the articles, after his appointment, his office will be vacated, and in case any unqualified person acts as the director of the company after the expiry of this period reserved for him to acquire qualification shares, he shall be liable to a fine not exceeding Rs. 50, for every day after the expiration of the said period and up to the last date on which he is proved to have acted as a director (Sec. 85). Where the articles laid down that the directors might appoint additional directors up to the prescribed maximum, it was held that this express power vested in the board excluded any implied concurrent power to the same effect in the company and the board had the sole power of appointing additional directors (*Blair Open Hearth F. Co.* v. *Reigart,* (1913) 108 *L. T.* 665). It is further laid down that in case a director has acted without the requisite qualification, or in case the said qualification or his appointment itself was found to be defective at a later stage, that will not of itself invalidate his acts as a director, but this rule will not apply to acts done after it has been shown that the appointment of the

said director was invalid (Sec. 86). Clauses in the articles on the same footing are also common, the objects of which being to make acts of *de facto* directors as valid and binding as those of *de jure* directors. It may be further added that in case a director ceases at any time to hold his qualification, his office shall be vacated within two months, or any shorter time as may be fixed by the articles, of his ceasing to hold such qualification.

According to old decisions if a person accepted an appointment and acted as a director with the knowledge that according to the articles a certain number of share qualification was compulsory, that in itself was held to be an agreement to obtain the necessary shares within a reasonable time if he did not possess them, with the result that in case he failed to obtain the necessary qualification within a reasonable time the company could place him on the register in respect of that number of shares. Now that Sec. 85 prescribes the consequences of a director failing to comply with the requirements of acquiring the said qualifications this old law according to the best authorities has been superseded. In *Spencer* v. *Kennedly,* (1926) 1 *Ch. D.* 125, where the articles especially provided the qualification of a director as "the holding of at least one share" and another article empowered the directors to appoint any other "qualified person" either to fill a casual vacancy or as an addition to the board and at one of its meetings appointed two men as directors whose transfers had been accepted, but who had not been placed on the register of members, it was held that although these men had acquired an absolute right to be registered, they were not "qualified persons" before actual registration and that their registration as directors was invalid. In *Brown and Green, Ltd.* v. *Hays* (1920) 36 *T. L. R.* 330, it was decided that salary paid to an unqualified managing director can be recovered by the company. With regard to the acts of an irregularly constituted board it was held in *Changa Mal v. The Provincial Bank Ltd.,* (1914) 36 *All.* 412 that an allotment of shares by an irregularly

constituted board is *prima facie* invalid. But this defect may sometimes be cured if the articles of association of the company provide for the validation of an act done by a *de facto* director in a *bona fide* manner. The other principle laid down in the same case is that "if there is no notice of allotment of shares in a company given to an applicant before the company goes into liquidation, such applicant is not liable to be placed on the list of contributories."

As between the company and the third persons having no notice to the contrary, the directors *de facto* are directors *de jure* (*The Hope Mills Ltd.* v. *Sir Cowasji J. Readymoney*, (1911) 13 *Bom. L. R.* 162). In a case the question under the new English Act came up for relieving a director from liability incurred by him in respect of having acted as a director and received remuneration as such after he ceased to be a director by reason of his having failed to obtain the share qualification required by the articles of association within two months of his appointment. The Court held that it had jurisdiction to grant relief under Sec. 372 (2) of the English Companies Act of 1929 from penal or civil liabilities incurred by him through this default but in case of civil liability the Court will not exercise the jurisdiction without evidence of the attitude of all persons interested in the enforcement of such liabilities (*Re. Barry & Staines Linoleum Ltd.*, (1933) 176 *L. T.* 330).

We have already seen that no person is capable of being appointed a director unless he has filed a statement with the registrar consenting in writing to act and signed by himself. In this connection Sec. 85 of the Indian Companies Act is important which runs as follows :—

Sec. 85 (1) Without prejudice to the restrictions imposed by Sec. 84, it shall be the duty of every director who is by the articles required to hold a specified share qualification, and who is not already qualified, to obtain his qualification within two months after his appointment, or such shorter time as may be fixed by the articles.

(2) If, after the expiration of the said period or shorter time, any unqualified person acts as a director of the company, he shall be liable to a fine not exceeding fifty rupees for every day between the expiration of the said period or shorter time and the last day on which it is proved that he acted as a director.

From this section read along with S. 86I (1) it follows that where the articles do not authorise a director to act before acquiring his qualification he must before so acting get his qualification and that too within a reasonable time after his appointment even though he may not have acted in the meantime (*Spencer* v. *Kennedy*, (1926) 1 *Ch.* 125). Under any circumstances, however, it is his duty under S. 85 read along with 86I (1) to acquire his satisfactory share qualification within two months after his appointment (*Hutchinson's Case, Re. Issue Co.*, (1895) 1 *Ch.* 226; *Molineaux v. London, Birmingham and Manchester Co.*, (1902) 2 *K. B.* 589). In the latter case signing a prospectus issued to the public was held to be acting as a director. The qualification shares which a director is expected to get may be acquired by him either from the company or by purchase from the market or by transfer from a friend without payment (*Katruck's Case,* (1888) 13 *Bom.* 1). There are cases where the articles require a director to hold qualification shares (in his own right). This will mean that though he can hold the same as a trustee without beneficial ownership and comply with this requirement of the articles he cannot do so if he holds them in a representative character such as that of an executor or the liquidator for another company (*Pulbrook* v. *Richmond Consolidated Mining Co.*, (1878) 9 *Ch. D.* 610; *Boschoek Proprietary Co.* v. *Fuke,* (1906) 1 *Ch.* 148). We have already seen that these qualification shares cannot be received as a gift because that would amount to a misfeasance being in the nature of a bribe and a director who accepts such shares will have to account to the company for the value of the shares or damages sustained by the company in consequence of breach of duty (*Hay's Case,* (1875) 10 *Ch. App.* 593; *Archer's Case,* (1892) 1 *Ch.* 322).

If before accepting the offer of the director to take up his qualification shares the company goes into liquidation, the contract cannot be completed and a director cannot be made liable by placing his name on the register thereafter in liquidation (*Hutchinson's Case, Re. Issue Co.*, (1895) 1 *Ch.* 226). If the articles do not provide for a sole holding, a joint holding will suffice as a qualification (*Grundy* v. *Briggs*, (1910) 1 *Ch.* 444). Where holding in his own right is provided for by the articles, an executor or administrator and trustee in bankruptcy as such will not be qualified (*Glory Paper Mills, Re. Dunster's Case*, (1894) 3 *Ch.* 478). The share must be held in such a way that the company can safely deal in the same if necessary (*Sutton* v. *English and Colonial Produce Co.*, (1902) 2 *Ch.* 502). The fact of a director having pledged his shares on a blank transfer will not disqualify him (*Pulbrook* v. *Richmond Consolidated Mining Co.*, (1878) 9 *Ch. D.* 610). If however these qualification shares were accepted from a promoter to whom the director handed a blank transfer it would amount to a misfeasance and the director would be liable, in liquidation, to contribute the nominal amount of the shares (*London and South W. Canal*, (1911) 1 *Ch.* 346). There have been some cases where the articles are so framed that they declare that if a director has accepted his nomination and thereafter not acquired his qualification with a specified period, he shall be taken to have applied for and the company to have allotted the necessary shares. Such article or articles similarly worded would not only make the director bound to take up shares allotted by the company while it is a going concern, but immediately on the expiration of the period named by the articles whether the company has placed his name on the register or not, if liquidation intervenes, the liquidator may place his name on the list of contributories and this can be done even though he has not acted as a director after accepting office (*Isaac's Case*, (1892) 2 *Ch.* 158; *Hercynia Copper Co.*, (1894) 2 *Ch.* 403). If however

the director resigns within the period allowed to him for acquiring his qualification shares, he escapes liability to acquire the same (*Salisbury Jones's Case,* (1894) 3 *Ch.* 356). When a director becomes bankrupt, he does not after notice to the company by his trustee in bankruptcy, hold his qualification shares in his own right according to law (*Sutton* v. *English and Colonial Produce,* (1902) 2 *Ch.* 502). In case where the qualification is increased after a director has qualified to the extent prescribed at his appointment, he remains a director even though he does not acquire a larger qualification within the prescribed time, though in case he continues to act as a director, that would be regarded as his agreeing to take up this extra qualification within a reasonable time (*Molineaux* v. *London, Birmingham and Manchester Co.,* (1902) 2 *K. B.* 589). A director who acts without qualification in breach of this requirement of the Act is not only likely to be prevented by an injunction restraining him from acting, but he is also liable to refund the fees paid to him by the company by mistake while he so acts (*In Re. Bodega Co.,* (1904) 1 *Ch.* 276). It has also been held that the appointment and qualification of directors relate to the internal management of a company and therefore any person dealing in good faith with the company is entitled to assume that everything is being done regularly (*Mahoney* v. *East Holiford Co.,* (1874) *L. R.* 7 *H. L.* 869). Of course it would be quite a different position if a person dealt with the company in spite of knowing this defect in the qualification of the director and his appointment.

Vacation of office of Director

Under the old Act there was no provision within the body of the Act as to the circumstances under which the directors vacated their office *ipso facto,* though articles of most companies provided for same. It was however thought that a specific provision in the Act was necessary because if in case a company omitted this clause from the articles there was nothing to force even a bankrupt director

from vacating his office. This Section 86 (i) now specifically lays down that the office of directors shall be vacated if—

(a) he fails to obtain within the time specified in sub-section (1) of Section 84, or at any time thereafter ceases to hold, the share qualification, if any, necessary for his appointment, or

(b) he is found to be of unsound mind by a Court of competent jurisdiction, or

(c) he is adjudged an insolvent, or

(d) he fails to pay calls made on him in respect of shares held by him within six months from the date of such calls being made, or

(e) he or any firm of which he is a partner or any private company of which he is a director without the sanction of the company in general meeting accepts or holds any office of profit under the company other than that of a managing director or manager or a legal or technical adviser or a banker, or

(f) he absents himself from three consecutive meetings of the directors or from all meetings of the directors for a continuous period of three months whichever is the longer without leave of absence from the board of directors, or

(g) he or any firm of which he is a partner or any private company of which he is a director accepts a loan or guarantee from the company in contravention of Section 86D, or

(h) he acts in contravention of Section 86F.

The above grounds are the grounds specifically laid down by the section but the section further lays down that *nothing contained in this section shall be deemed to preclude a company from providing in its articles that the office of directors shall be vacated on grounds additional to those specified in this section* [Sec. 86 (i) (2)].

Where a director and manager of a company entered into an agreement with the company to resign both position in consideration of cash payment and agreeing not to carry on similar business for five years it was held that the restrictive covenant was not rendered invalid because it was entered into on the termination of the employment

instead of at the beginning. (*Spink* (*Bournemouth*) *Ltd.* v. *Spink,* (1936) 1 *Ch.* 544).

Bankrupt Directors, Managers and Managing Agents

It is now laid down specifically by Section 86A in addition to the provision of disqualification as provided *for by Section 86 (i) (c) that in case an undischarged insolvent acts as a director or managing agent or manager of any company he shall be liable to imprisonment for a term not exceeding two years or to a fine not exceeding Rs. 1,000 or to both. This section covers both companies incorporated within British India and outside British India.*

In this connection it is interesting to notice that this section was introduced following a similar Section 142 of the English Act which was enacted on the recommendation of the Greene Commission which laid down that:—

"The evidence upon this subject discloses a state of affairs which is difficult to deal with but in our opinion demands a remedy. Many cases have been brought to our notice where bankrupts who have not obtained their discharge have been able, by using the machinery of the Companies Acts, to continue trading under the disguise of a limited company, with results often disastrous to those who have given credit to the company. In many cases, traders have been far too ready to give credit to private companies of which they know nothing, without making any or sufficient inquiries as to the financial standing of the company or the persons who control, it, and to this extent it may fairly be said that the trouble lies at their own door. This is particularly the case where manufacturers in periods of trade depression have been eager at any risk to find a sale for their goods. But in spite of these considerations, we are of opinion that an amendment of the law so as to prohibit an indischarged bankrupt from taking part in the management of a company without the leave of the Bankruptcy Court concerned is desirable. An absolute prohibition would, we think, operate unfairly and we suggest the Bankruptcy Court as the one to give the necessary sanction because the Judge of that Court will more readily be acquainted with the circumstances attending the bankruptcy. Having regard to the class of individual concerned in the majority of cases, we consider it essential that any breach of the provision which we recommend should be punishable by imprisonment."

REMOVAL OF DIRECTORS

Unless the articles gave power to the company in general meeting to remove directors it was not within the power of shareholders under the old Act to do so. The Indian Companies (Amendment) Act of 1936 however provides that *the company may by extraordinary resolution remove any director, whose period of office is liable to determination at any time by retirement of directors in rotation, before the expiration of his period of office and may by ordinary resolution appoint another person in his stead. The persons so appointed shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose place he is appointed was last elected director. A director so removed cannot be reappointed a director by the board of directors (Sec. 86G).* It may be added that this section applies as will be noticed only *to those directors whose period of office is liable to determination at any time by retirement of directors in rotation*, by which saving clause the section attempts to exclude ex-official directors nominated by the managing agents as well as debenture directors and special directors nominated by holders of large blocks of shares particularly in cases where public bodies or Indian States frequently invest largely in companies by purchasing shares or debentures and make it a condition that in consideration of so doing they shall have the power to nominate one or more directors of their choice from falling under the operation of this section.

It may be further added that this section does not apply to directors elected or appointed before the commencement of the Indian Companies (Amendment) Act of 1936 [*Sec. 86G (2)*].

Where in a recent case, the articles of association laid down to the effect that the one-third of the first directors to retire, unless the directors agree among themselves, shall be determined by ballot it was held by the Appeal Court that the words " by ballot " meant by lot and that the words " the whole number of directors " in the article did not

include additional directors who by another article only held office until the ordinary general meeting (*Eyre* v. *Milton Proprietary Ltd.,* (1936) 1 *Ch.* 244).

Articles in connection with appointment and other incidents such as remuneration, qualification, etc., of Directors

Usually articles of association in India contain special clauses appointing or stating the names of the first directors. If any special directors are to be appointed because they are members of the firms of managing agents, or they are to be appointed as debenture directors, the same is provided for by the articles. Frequently clauses are inserted for the appointment of alternate directors for filling up vacancies in the office of directors, for providing qualification shares to be taken up by them, remuneration of directors, the retirement by rotation and how the retirement by rotation has to be provided for. Sometimes a clause is inserted giving power to the company for increasing or reducing the number of directors. We shall deal with these clauses now hereunder.

Form of Article as to number of Directors

"Until otherwise determined by the general meeting, the number of directors shall not be less than six nor more than twelve."

The above is the usual form in which this point is stated in the articles.

There is a second form recently used by some Indian companies which not only provides for the miximum number excluding *ex-officio* directors, but also fixes a percentage of these directors being Indians. This runs as follows :—

"Until otherwise determined by a general meeting the number of the directors shall, excluding *ex-officio* directors, not be less than three or more than six of whom 80 per cent. shall always be Indians."

Form of Article appointing Directors

The first directors of the company shall be :—

K. M. Rama Dass, Esq. (Messrs. Managing Agents & Co.), Special Director, Chairman.

R. M. Bahadurji, Esq.

C. S. Jehangir, Esq.

Hon. Mr. V. D. Thackersey.

G. Khatau, Esq.

F. C. Ebrahim, Esq.

N. M. Goculdas, Esq.

A. J. Sivaprasad, Esq. (Messrs, Managing Agents & Co.), Special Director.

NOTE :—In this connection the attention of the draftsman is drawn to Section 17(2) of the Indian Companies (Amendment) Act of 1936 where it is provided that the articles of association of every company must contain regulation 78 or regulations "identical with or to the same effect." Regulation 78 lays down as follows :—

"At the first ordinary meeting of the company, the whole of the directors shall retire from office, and at the ordinary meeting in every subsequent year, one-third of the directors for the time being or, if their number is not three or a multiple of three, then the number nearest to one-third shall retire from office."

Thus it will be necessary under this regulation that at the first ordinary meeting of the company the whole of the directors whether appointed by the articles or otherwise must retire from office and at the ordinary meeting every subsequent year one-third of the directors or the multiple provided for must retire. The object here sought to be achieved is to give the shareholders the choice at the first ordinary meeting of the company to change their directors if they do not approve of them. There is of course no mention as to *ex-officio* directors but that fact should not cause any serious obstruction in view of the fact that special or *ex-officio* directors are nominated by managing agents according to their agreements and they may be reappointed by them independently of the general body of the shareholders of the company.

The other form in which the same article appears is :—

"The persons hereinafter mentioned shall be the first directors that is to say :—(Here the names and particulars as in the above form are mentioned).

Form of Article for Special Directors

"One of the members of the said firm of (Messrs. Managing Agents & Co.), Bombay, which now consists of 'X,' 'Y' and 'Z,' whilst the said firm or their successors hold between them shares in the capital of the company of the nominal value of rupees five lacs, shall from time to time be a director of the company, and the said firm shall also have the right, during the same time, to appoint another director, whether a member of the firm or not. The directors appointed under this clause are herein referred to as 'special directors' and the term 'special directors' herein contained includes the several directors for the time being in the office under this clause."

Frequently special directors in India are also *ex-officio* directors and the articles take the following form:—

The firm of Messrs............. (managing agents) shall be entitled to have three nominees on the directorate of the company. Each of the said nominees and their successors in office appointed under this clause shall be called an *ex-officio* director. An *ex-officio* director shall be entitled to hold office until requested to retire the said Messrs............and accordingly shall not be bound to retire by rotation. As and whenever an *ex-officio* director vacates office whether upon request as aforesaid or by death or otherwise, the said Messrs....................may appoint another director in his place. An *ex-officio* director shall not require any qualification. An *ex-officio* director may at any time by notice in writing to the company resign his office."

There is one other form in which this very same article appears as :—

"During such time as the firm of Messrs. Cobb & Co., shall be the managing agents of the company, that firm shall also have the right to appoint and from time to time remove and reappoint another person, whether a member of that firm or not, as a director of the company. The director appointed under this article is herein referred to as the 'special director,' and the term 'special director' means the director for the time being in office under this article."

Other alternate form is as follows :—

"As agreed in accordance with Schedule 'A,' (Agreement of the company with the managing agents annexed to the articles), to the extent of two persons named by the agents as deemed fit shall

be *ex-officio* directors of the company and such directors shall, as such be not liable to retire by rotation or be removed from the same office and none of the provisions relating to the retirement qualification or disqualification of directors shall apply to them."

The other three alternate forms are :—

(1) "During such time as the firm of Messrs. A. B. C. Company shall be the managing agents of the company, any one member of that firm nominated by that firm in writing shall be *ex-officio* director of the company. The right conferred by this article shall not be determined by any change in the name style or constitution of the firm of Messrs. A. B. C. Company."

(2) "Such one of the managing directors or acting managing directors for the time being resident in..........of the B. Company Limited as the B. Company Limited shall from time to time nominate in that behalf shall be a director *ex-officio* and the Chairman of the Board."

(3) "During such time as the firm of Messrs. K. N. & Company or the successors in business of that firm shall be the agents of the company, one member of that firm shall be *ex-officio* a director of the company and he shall also be *ex-officio* the chairman of directors; and during such time as the firm of Messrs. K. N. & Company or the successors in business of that firm shall hold in their own names or in the name or names of one or more of the members of that firm or their successors in business shares in the company of the nominal value of not less than Rs............ one member of the firms of Messrs. K. N. & Company or their successors shall also be *ex-officio* a director of the company. The rights conferred by this article shall not be determined by any change in the name or style of either of the said firms or their successors in business as aforesaid, or in the constitution of either of the said firms or their successors."

Form of Article of Life & Ex-officio Director in case of Private Companies

In case of private companies where directors are appointed generally for life and in some cases where the managing agency is established (which is of course very rare and unusual), the following form of article is used :—

"E. R. Rustomji, Esq., A. Erachshaw, Esq. and R. G. Ardeshir, Esq., shall be the first directors of the company and shall continue to be directors of the company for life so long as they shall not become disqualified for any of the causes specified in these articles.

One of the members of the managing agents' firm of E. R. Rustomji & Co., shall be an *ex-officio* director of the company. The right of appointment of *ex-officio* director of the company shall not be determined by any change in the name or style of the said firm or its successors."

There is frequently an article inserted such as the following to make sure that the right to appoint special or *ex-officio* directors is not terminated by the change in the name of the agents' firm :—

"The right of appointment of special directors of the company as provided for by the last preceding clause shall not be determined by any change in the name or style of the said firm or its successors aforesaid in business."

Form of Article for Debenture Directors

Frequently debenture holders are given the right to appoint directors as we have seen in course of discussion in this chapter elsewhere. The form which this article usually takes in case of Indian Companies is as follows :—

"The holders of debentures of the company shall have the right to appoint and from time to time to remove and reappoint a director (or say, two or three directors as may be required), in accordance with the provisions of the trust deed securing the said debentures. The director appointed under this article is herein referred to as the 'debenture director' and the term 'debenture director' means the director for the time being in office under this article."

Alternative form of article when the majority of debenture holders are to appoint their directors :—

"The holders of a majority of the debentures of this issue may appoint two directors of the company and they shall be entitled at all times before the principal moneys hereby secured are paid to fill up any vacancy in the office of any director so appointed. The holders of three-fourths of the said debentures may remove any director so appointed. The company shall pay every such director by way of remuneration a sum calculated at the rate of Rs...............per annum."

In case when debenture issue is contemplated or has to be provided for, for the future an article such as the following may be inserted :—

If and when debentures of the company shall be issued, the holders thereof shall have the right to appoint and from time to time to remove and reappoint a director, in accordance with the provisions of the trust deed securing the said debentures. The director appointed under this article is herein referred to as the "debenture director" and the term "debenture director" means the director for the time being in office under this article.

Frequently this power to appoint debenture directors is given to the trustees appointed by the debenture trust-deed in which case the article would appear in more or less in the following form :—

"Where a trust deed for securing debentures issued by the company special provision for appointment of trustees for the debenture-holders is made the said trust deed may if so arranged provide for the appointment of some person or persons from time to time by the said trustees of the said trust deed to be a director or directors of the company and the said trust deea may empower such trustees to remove any of the directors so appointed from time to time and may also provide that the director or directors so appointed shall not be bound to hold any qualification shares and shall vacate office in any special event and may give the said trustees powers to fix the remuneration of such director or directors and may also provide that the said directors shall not vacate office in rotation and shall not be removed by the company and may contain such other provisions as may be arranged between the company and the trustees, ancillary to the above all such provisions shall have effect notwithstanding any of the other provisions therein contained."

Form of Article for Mortgage Directors

Frequently some companies give power even to mortgagees to appoint directors if the mortgage deed so provides. The form of article in this case is as follows :—

"If and when the company shall create a mortgage of the properties movable or immovable belonging to it including its uncalled capital, the mortgagee shall have the right to appoint and from time to time remove and reappoint a director or directors in accordance with the provisions of the deed of mortgage securing the amount lent and advanced by him. The directors appointed under this article are herein referred to as 'mortgage directors' and the term 'mortgage directors' shall be deemed to mean the directors for the time being in office under this article."

Form of Article for Alternate Director

The power to appoint an alternate director is a very useful power in case where the directors or some of them are likely to leave British India temporarily and it is thought desirable that during their absence another duly qualified person should be appointed to fill up the gap temporarily. This is provided for by articles in the following form :—

"A director who is out of India or about to go out of India *for not less than three months* may, with the approval of the directors, appoint any duly qualified person to be an alternate director during his absence abroad and such appointment shall have effect and such appointee whilst he holds office as an alternate director shall be entitled to notice of meetings of the directors and to attend and vote thereat accordingly, but he shall *ipso facto*, vacate office if and when the appointer returns to India or vacates office as a director. Any appointment under this clause shall be effected by notice in writing under the hand of the director making the same."

NOTE :—Frequently this provision is also made with a view to assist a director who is likely to remain out of the "*district in which meetings of directors are ordinarily held*" (*Sec. 86B*) for some part of the year. It should be noted here that now according to Sec. 86B the power to appoint an alternate or substitute director can only be exercised by a director on the condition that (1) the same is exercised with the approval of the board of directors and (2) the director is going to be absent for not less than three months from the district in which meetings of directors are ordinarily held. For this purpose the presidency towns of Calcutta and Madras are deemed to part of the twenty-four parganas and Chingleput districts respectively and the Presidency Town of Bombay is deemed to be part of the Bombay suburban and the Thana districts.

In some cases this appointment of alternate directors is made subject to a special leave of absence being taken from the directors. In this case the article would run as :—

"A director who with special leave of absence from the

directors as provided in these articles absents himself or is about to absent himself from the meetings of the board *because he is to absent himself for not less than three months from the district in which meetings of the directors are ordinarily held,* may with the approval of the board appoint, etc." (Here the rest of the above form follows).

Form of Article for filling up vacancies

Filling up vacancy by the directors in the midst of the year is a power most convenient and necessary and the article takes the following form in that connection :—

"Subject as aforesaid the directors shall have power at any time, and from time to time, to appoint any other qualified person to be director, either to fill a casual vacancy or as an addition to the Board, but so that the total number of directors shall not at any time exceed the maximum number fixed as above, and so that no such appointment shall be effective unless two-thirds of the directors concur therein, and any person so appointed shall retain his office only until the next following ordinary meeting. and shall then be eligible for re-election."

One other alternative article would be as follows :—

"The Board shall have power at any time and from time to time to supply any vacancies in their number arising from death, resignation, or otherwise and also to add to their number subject to the maximum as provided by clause No.......of these presents."

Form of Article for continuing Directors with a number lesser than a quorum

Frequently a situation is suddenly caused either by death or resignation under which the minimum number fixed for quorum is reduced. In that case the provision of an article such as the following is most useful and is to be found in the articles of association of many Indian and English Companies :—

"The continuing directors may act notwithstanding any vacancy in their body but so that in case their number falls below the minimum as fixed by these presents or below the quorum as provided for by Clause No.......the directors shall not act except for the purpose of filling up vacancies so long as the number

remains below the minimum and less than that provided for the quorum."

Form of Article for qualification of Directors

It is now universal to provide for the share qualification of directors and the clause generally runs as follows :—

"The qualification of a director (other than the *ex-officio* director, the special director or the debenture director) shall be the holding of shares in the company of the nominal value of Rupees two thousand five hundred at least registered in his name, and it shall be his duty with regard to such qualification to comply with the provisions of Section 85 of the Indian Companies Act; provided that a first director may act before acquiring his qualification, but he shall in any case acquire the same within two months of his appointment, and unless he shall do so, he shall be deemed to have agreed to take the said shares from the company and the same shall be forthwith allotted to him accordingly."

Another alternative form :—

"Every director shall at the time of his appointment and thenceforth during his continuance in office hold in his own name shares in the company of the nominal value of Rs.........at the least."

Form of Article for remuneration of Directors

We have already seen that directors are not entitled to any remuneration unless the article provide for same or the general meeting allows it by a resolution. The directors are also not entitled to any travelling expenses to and from board meetings unless provided for by the articles or sanctioned by company in general meeting even though they are entitled to be indemnified against all expenses (*Young* v. *Naval and Military Society,* (1905) 1 *K. B.* 687; *Marmor Ltd.* v. *Alexander,* (1908) *S. C.* 78). The universal practice in all companies both in India and England happens to be to provide for remuneration in the articles by a special clause. The clause runs more or less as follows :—

"The remuneration of the directors for their services shall

be Rupees seventy-five for each meeting attended by them and the directors shall be paid such further remuneration (if any) as the company in general meeting shall from time to time determine, and such further remuneration shall be divided among the directors in such proportion and manner as the directors may from time to time determine. The directors may allow and pay to any director, who is not a *bona fide* resident in Bombay, and who shall come to Bombay, for the purpose of attending a meeting, such sum as the directors may consider fair compensation for his expenses and loss of time in connection therewith, in addition to his fee for attending such meeting as above specified."

The other alternative form by which a provision is made not only for remuneration for attendance at meetings but also for extra services and travelling expenses as decided upon by the board itself, is as follows :—

"The remuneration of a director shall be a sum not exceeding Rs. 50 (as the board may determine) for every meeting of the Board attended by him; and such reasonable additional remuneration, as may be fixed by the board of directors, may be paid to any one or more of their members for services rendered by him or them in journeys to the works or inspections of the property of the company, or in signing the share-certificates in respect of the company's capital or any debentures issued by the company, and the directors shall be paid such further remuneration (if any) as the company in general meeting shall from time to time determine; and such remuneration and further remuneration shall be divided among the directors in such proportion and manner as the directors may from time to time determine, and in default of such determination within one year, equally.

The board may allow and pay to any director, who is not a *bona fide* resident of Ahmedabad, for the purpose of attending a meeting, such sum as the board may consider fair compensation for his travelling expenses in addition to his fee for attending such meeting as above specified."

Form of Article for retirement by rotation of Directors

In this connection it should be now noted that regulations 78, 79, 80, 81 and 82 are now virtually speaking compulsory under Section 17 (2) because there it is laid down that *these regulations in any event will be deemed to be contained by the articles of association of every*

company. We have already dealt with regulation 78 above under the heading of "Articles appointing directors." We may however requote all these articles for the guidance of the draftsman who should bodily embody them in the articles, making such slight touches which do not fall under material alterations of the substance of the requirement concerned. The regulations are as follows :—

78. At the first ordinary meeting of the company, the whole of the directors shall retire from office, and at the ordinary meeting in every subsequent year, one-third of the directors for the time being or, if their number is not three or a multiple of three, then the number nearest to one-third shall retire from office.

79. The directors to retire in every year shall be those who have been longest in office since their last election, but as between persons who became directors on the same day those to retire shall (unless they otherwise agree among themselves) be determined by lot.

80. A retiring director shall be eligible for re-election.

81. The company at the general meeting at which a director retires in manner aforesaid may fill up the vacated office by electing a person thereto.

82. If at any meeting at which an election of directors ought to take place, the places of the vacating directors are not filled up, the meeting shall stand adjourned till the same day in the next week at the same time and place, and, if at the adjourned meeting the places of the vacating directors are not filled up, the vacating directors or such of them as have not had their places filled up shall be deemed to have been re-elected at the adjourned meeting.

It may be however pointed out that according to Section 83B (2)

"Notwithstanding anything contained in the articles of a company other than a private company not less than two-thirds of the whole number of directors shall be persons whose period of office is liable to determination at any time by retirement of directors in rotation."

This of course applies to companies incorporated after the commencement of the Indian Companies (Amendment) Act of 1936. Thus the directors for whom provision for retirement by rotation has to be made are these two-thirds

or more by the draftsman of the articles, the others being not subject to such retirement.

Specimen clauses from precedents with due alterations :—

"At the ordinary meeting to be held in the year 1937 and at every succeeding ordinary meeting whole of the directors, shall retire from office.

In every subsequent year one-third of the directors for the time being shall retire from office. The directors to retire shall be those who have been longest in office. As between two or more who have been in office an equal length of time, the director to retire shall, in default of agreement between them, be determined by lot. The length of time a director has been in office shall be computed from his last election or appointment where he has previously vacated office. A retiring director shall be eligible for re-election.

The company at any general meeting at which any directors retire in manner aforesaid shall fill up the vacated office by electing a like number of persons to be directors; provided that it shall not be obligatory upon the company to fill up any vacancy or vacancies not necessary to be filled up in order to make up the minimum number of directors required under article No..........

If at any general meeting at which an election of directors ought to take place, the place of any retiring director is not filled up, such director shall, if willing to continue in office, be deemed to have been re-elected at such meeting, unless it shall be determined at such meeting to reduce the number of directors, or to leave any vacancy unfilled."

NOTE :—In connection with above it should be noted that each name should be voted on separately and a list should not be put forward to be voted on together.

Form of Article Empowering the Company to increase or Reduce the Number of Directors

Frequently articles give power to the company to increase or reduce the maximum number of directors or to alter their qualification and the article generally runs as follows :—

"The company in general meeting may, by special resolution, from time to time increase or reduce the number of directors, and may alter their qualification and the company may by special

resolution remove any director (not being a special director or the debenture director) before the expiration of his period of office, and appoint another person in his stead. The person so appointed shall hold office during such time only as the director in whose place he is appointed would have held the same if he had not been removed."

In one recent case, *viz.*, *Gur Prasad Kapoor* v. *Rameshwar Prasad*, (1933) 55 *All.* 389 where one of the articles of a company provided that "until otherwise determined by a general meeting, the number of directors shall not be less than five nor more than nine" and by a resolution passed at a general meeting of the shareholders the number of directors was increased to sixteen, it was held that the alteration was valid and no special resolution was required therefor. The right construction of the article according to the Court was that it was open to shareholders to vary the number of directors therein referred to without in any way necessitating an alteration in the article itself.

Who can be a Director ?

There is no restriction as far as the Company's Act is concerned as to who can be a director and if the articles allow, a corporation or a joint stock company may be appointed a director (*Bulawayo Market and Offices Co.*, (1907) 2 *Ch.* 458). A person nominated under Section 80 of the Indian Companies Act to represent the company may also act as a director. It is not necessary that a director should hold any share or that he should be a shareholder unless the articles of association provide for a share qualification.

The Indian Companies Act does not specifically and clearly define a director. All that Section 2 (5) lays down is that a "Director includes any person occupying the position of a director by whatever name called;" it also provides that except in case of a private company, every company registered after the commencement of the Indian Companies Act of 1913 shall have three directors. In this

connection two further sections of the Act are important, *viz.*, Secs. 83B, 84 and 87I. They are as follows :—

83B. (1) In default of and subject to any regulations in the articles of a company other than a private company—

(*i*) the subscribers of the memorandum shall be deemed to be the directors of the company until the first directors shall have been appointed;

(*ii*) the directors of the company shall be appointed by the members in general meeting; and

(*iii*) any casual vacancy occurring among the directors may be filled up by the directors, but the person so appointed shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose place he is appointed was last appointed a director.

(2) *Notwithstanding anything contained in the articles of a company other than a private company not less than two-thirds of the whole number of directors shall be persons whose period of office is liable to determination at any time by retirement of directors in rotation;*

Provided that nothing herein contained shall apply to a company incorporated before the commencement of the Indian Companies (Amendment) Act, 1936, where by virtue of the articles of the company the number of directors whose period of office is liable to determination at any time by retirement of directors in rotation falls below the two-thirds proportion mentioned in this section.

84. (1) A person shall not be capable of being appointed director of a company by the articles, and shall not be named as a director or proposed director of a company in any prospectus issued by or on behalf of the company or in relation to any intended company or in any statement in lieu of prospectus filed by or on behalf of a company, unless, before the registration of the articles or the publication of the prospectus, as the case may be, he has, by himself or by his agent authorised in writing—

(*i*) signed and filed with the registrar a consent in writing to act as such director; and

(*ii*) save in the case of *companies* not having a share capital either signed the memorandum for a number of shares not less than his qualification (if any), or *taken from the company and paid or agreed to pay for his qualification shares* or signed and filed with the registrar a contract in writing to take from the

company and pay for his qualification shares (if any), *or made and filed with the registrar an affidavit to the effect that a number of shares, not less than his qualification (if any), are registered in his name.*

(2) On the application for registration of the memorandum and articles, *if any,* of a company the applicant shall file with the registrar a list of the persons who have consented to be directors of the company, and, if this list contains the name of any person who has not so consented, the applicant shall be liable to a fine not exceeding five hundred rupees.

(3) This section shall not apply to a private company or *a company which was a private company before becoming a public company* nor to a prospectus issued by or on behalf of a company after the expiration of one year from the date at which the company is entitled to commence business.

87I. *Notwithstanding anything contained in the articles of a company other than a private company the directors, if any, appointed by the managing agent shall not exceed in number one-third of the whole number of directors.*

Besides the above Sec. 32 (2) (l) every company has to include in its annual return of the list of members and summary, a statement as to the names and addresses of the persons who at the date of the return are the directors of the company and of the persons (if any) who at the said date are the managers *or managing agents of the company, and the changes in the personal of the directors, managers and managing agents since the last return together with the dates on which they took place.*

REGISTER OF DIRECTORS, MANAGERS AND MANAGING AGENTS

Under Sec. 87 of the Indian Companies (Amendment) Act of 1936 a company is required to keep at its registered office not only a register of its directors, as in the case of the old Act, but also that of managers and managing agents in which with respect to each of these officers various particulars have to be recorded. In case of an individual director, manager or managing agent, his present name in full, any former name or surname in full, his usual

residential address, his nationality and if that nationality is not the nationality of origin, his nationality of origin and his business occupation, if any, and if he holds any other directorship or directorships, the particulars of such directorship or directorships have to be stated. In case where any of these offices are held by a corporation, the register must state its corporate name and registered or principal office and the full name, address and nationality of each of its directors. In case however a firm holds any of these offices, the register must include the full name, address and nationality of each partner and the date on which each became a partner. The company must within 14 days from the appointment of the first directors of the company and of the same period of happening of a change in such appointment send to the registrar a return. This register must be kept open during business hours to the inspection of any member of the company without charge and of any other person on payment of rupee one or such less sum as the company may impose upon each inspection, subject of course to such reasonable restrictions as the company may by its articles or in general meeting impose, so that not less than two hours in each day be allowed for inspection. In case any default is made in this connection or if inspection is refused, the company and every officer of the company knowingly and wilfully in default is liable to a fine of rupees fifty and the Court may in case of such refusal on application made to it by the person concerned by order direct an immediate inspection of the register.

POWERS OF DIRECTORS

The exact powers of the directors largely depend on the clauses in the articles of association of the company concerned. Articles frequently lay down as is provided for by table "A," Clause 71, that the directors "may exercise all such powers of the company as are not, by the Companies Act, or any statutory modification thereof for the time being in force, or by these articles, required to be exercised by the company in general meeting, subject

nevertheless to any regulation of these articles, to the provisions of the said Act, and to such regulations being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting; but no regulation made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if that regulation had not been made." In this case these general powers are wide and all embracing and now by S. 17 (2) of the Indian Companies (Amendment) Act, 1936 all articles of association must include this clause 71 of Table A or a clause identical with or to the same effect and in any event this clause or regulation will be deemed to be contained in a company's articles.

The regulation 71 runs as follows :—

"The business of the company shall be managed by the directors, who may pay all expenses incurred in getting up and registering the company, and may exercise all such powers of the company as are not, by the Indian Companies Act, 1913, or any statutory modification thereof for the time being in force, or by these articles, required to be exercised by the company in general meeting, subject nevertheless to any regulation of these articles, to the provisions of the said Act, and to such regulations being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting; but no regulation made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if that regulation had not been made."

Thus the powers of directors to a certain extent have been standardised with very limited scope for variation by this new Sec. 17 (2). In absence of such standardisation it had become most frequent in case of companies under managing agency control, to divest the directors of almost all the normal powers of supervision and management by transferring same to the managing agents through cleverly devised articles and managing agency agreements. In case of some companies the article such as the following was quite usual "the managing agents shall exercise all the powers of management, supervision and conduct of the company as are not vested specifically to the board of

directors by the Indian Companies Act." It can be easily seen that by this method the functions of the boards of directors were reduced to the minimum almost to the limit of formally giving effect to what was already done by the managing agents.

It has been held in England that where directors are given powers either by articles or otherwise a liberal construction will be given to the clause conferring such powers (*Hampson* v. *Price's Patent Candle Co.*, (1876) 24 *W. R.* 754). If the powers are given to the directors company cannot interfere except in case where the statute require that being done by the company (*Automatic Self-cleansing Co.* v. *Cunningham,* (1906) 2 *Ch.* 34; *Gramophone & Typewriter Co.* v. *Stanley,* (1908) 2 *K. B.* 89; *Thomas Logan* v. *Davis,* (1911) 104 *L. T.* 914; *Salmon* v. *Quin and Axtens,* (1909) 1 *Ch.* 311; *A. C.* 442). Though here the powers are not concurrent because they are specifically vested in the directors, in case there is no board or the board will not or cannot exercise any power, the power can be exercised by the company as a residuary power (*Blair Open Hearth Furnace Co.* v. *Reigart,* (1913) 108 *L. T.* 665; *Barron* v. *Potter,* (1914) 1 *Ch.* 895; *Foster* v. *Foster,* (1916) 1 *Ch.* 532). In other cases specific powers in detail are laid down by the articles. The directors should see that they act strictly within their powers. If the directors exceed their powers and do some acts beyond their powers, the company in general meeting, may ratify this act, provided the said act is within the scope of the company's power (*Irvine, William* v. *The Union Bank of Australia,* (1877) 2 *Ap. Cases* 366). This ratification may be made by an ordinary resolution. When articles of a company provided "until otherwise determined by a general meeting the directors shall not be less than two and more than seven" and the articles also adopted cls. 83 and 85 of Eng. Table A (our cls. 89 and 91) it was held distinguishing *Blair Open Hearth Furnace Co.* v. *Reigart,* (1913) 108 *L. T.* 665 that the power of appointing additional directors had not been delegated

to the directors so as to exclude the inherent power of the company in general meeting to appoint directors (*Worcester Corseting Ltd.* v. *Witting,* (1936) 1 *Ch.* 640 see also *Gurprasad Kapur* v. *Rameshwar Prasad,* (1933) 55 *All.* 399). We have already seen how far a director can contract personally with the company. If the directors have done an *ultra vires* act, the act being *intra vires* the company, and in case the said company not only wants to ratify same, but also wants to give power to its directors to do similar acts in the future, that would amount to altering the articles and would have to be done by a special resolution (*Grant* v. *United Kingdom Switchback Rly. Co.,* (1889) 40 *Ch. D.* 138-39). In a recent case where the articles authorised the directors to provide for the welfare of employees and their widows and children, the Board of directors entered into a deed or covenant by which it granted a pension of £500 a year to the widow of managing director, it was held that the transaction was not for the benefit of the company or reasonably incidental to the company's business and that the pension did not come within the terms of the articles as the managing director, or other director is not a person " in the employment of the company " (*In Re. Lee, Behrens & Co., Ltd.,* (1932) 2 *Ch. D.* 46).

In one other case where it was agreed that the person who guaranteed the dividends on preference share was to be reimbursed by the company for any sum paid by him in respect of this guarantee, the Court held that the agreement was *ultra vires* the company (*Walters Palm Toffee Ltd.* v. *Walters,* (1933) 49 *T. L. R.* 192). The directors must act in the interest of the company and must not make any secret profit while allotting shares (*Parker* v. *McKenna,* (1875) 10 *Ch.* 96); or while making calls (*Gilbert's Case,* (1870) 5 *Ch.* 559); and while forfeiting shares the same rule has to be observed because the power to forfeit is to be exercised for the benefit of the shareholders (*Harris* v. *The North Devon Ry. Co.,* (1855)

20 *Beav.* 384). The same principle applies when dealing with a transfer (*In re. Cameron's C. S. L. Ry. Co.,* (1867) 5 *De G. M. & G.* 284).

The practice in India is to add to these general powers a specific powers clause and enumerate at great length as will be noticed from specimen given in this chapter as well as in small typed additions at the end of Chapter XI where Table A provisions are dealt with and compared with the articles in actual use in India. It is undoubtedly most advantageous from the perfect draftman's point of view to insert both the general and specific powers, particularly in view of the fact that these articles are to be constantly used and referred to by directors, shareholders and the public who are not experts in company law. However, it should be noted that in connection with the clause particularising the powers that as much detail should be inserted as possible so that the work of those who have occasion to refer to it is made easy so as to leave no doubt in their mind as to whether a particular power is within the scope. The directors of course should take care in connection with exercise of their powers to remember that their position in connection with the company is *fiduciary* and that whatever they do should be done with the paramount idea of benefiting the company and the company alone. Any abuse of their power would bring in an intervention of the Court (*Richmond's Case,* (1858) 4 *K. & J., page* 305; *Gilbert's Case,* (1870) *L. R.* 5 *Ch. App.* 559; *Piercy* v. *S. Mills & Co.,* (1920) 1 *Ch.* 77). Here there was an attempt to increase the capital with a view to secure voting power. *Clark* v. *Workman,* (1920) 1 *Ir. R.* 107, is another case where the directors wanted in exercise of their power to select a rival company as the transferee of their own shares which was prevented by the Court. In order of course to bring in the intervention of the Court a very strong and clear case of wrongful exercise of power should be brought in as otherwise the Courts are reluctant to interfere with the discretion of the directors and take it for granted that the same was *bona fide* exercised (*Penny,*

ex parte, In re. Gresham Life Assurance Society, (1872) *L. R.* 8 *Ch. App.* 446). The directors who exceed their powers would be held liable personally by third parties on the footing that they have given warrant of authority in some cases (*Collen* v. *Wright,* (1857) 8 *El. & Bl.* 647; *Firbank's Executors* v. *Humphreys,* (1886) 18 *Q. B. D.* 54; *Starkey* v. *Bank of England,* (1903) *A. C.* 114).

In exercise of their powers, the directors have to bear in mind that, the "objects clause" of the memorandum of association lays down the extent of powers of the company within the scope of which powers the company through memorandum and articles of association delegates to the directors such powers as it thinks necessary and convenient which the directors can exercise on their own accord without calling a meeting of the company and obtaining their consent. Anything beyond the powers as laid down in the articles, though within the objects clause, can only be done by the directors after obtaining sanction for same from the company in a general meeting. Of course it must however be remembered that whatever powers are given to the directors they have to be exercised by the board in a meeting where a proper quorum, as provided for by the articles, is present. If no quorum is provided for, a majority of the board must be present in order to form a quorum (*York Tramways Co.* v. *Willows,* (1882) 8 *Q. B. D.* 685). The directors of a registered company may resolve that one of their members shall form a quorum if the articles do not provide a quorum and the majority have met and have so resolved (*Umney* v. *Fire Proof Doors, Ltd.,* (1916) 2 *Ch.* 142). Where the articles authorise the directors to delegate any of their powers they can also delegate that power to a quorum of one as decided in the above case. In one recent case where the articles conferred upon the directors the power (1) to delegate to one or more of their number any of the powers of the board of directors, and (2) to decide who shall sign contracts and other documents on the company's behalf and a document purporting to be a guarantee was given to a third party

by the company signed by one of the directors on behalf of the company. *Scrutton* and *Gree* L. J. J. held that the company was bound in spite of the fact that board had not actually delegated because a person dealing with a company was not obliged to inquire whether the director had been actually invested with authority to do the act and was entitled to presume that the directors had authorised the director concerned to sign the contract of guarantee on behalf of the company (*British Thomson Houston Company, Ltd.* v. *Federated European Bank*, (1932) 2 *K. B.* 176; *Houghton & Co.* v. *Nothard, Lowe and Wills, Ltd.*, (1927) 1 *K. B.* 246 on appeal, (1928) *A. C.* 1 *distinguished;* see also *Kreditbank Cassel* v. *Schenkers, Ltd.*, (1927) 1 *K. B.* 826). The quorum must, of course, consist of persons who are competent to transact business before the meeting and thus the director who is disqualified from voting because he is interested in the transactions which the directors are considering cannot be counted in the quorum (*Yuill* v. *Greymouth Point Elizabeth Ry. Co.*, (1904) 1 *Ch.* 32). The director who is thus disqualified cannot be excluded from the meeting because the fact of his being interested does not disqualify him from being present (*Grimwade* v. *B. P. S. Syndicate, Ltd.*, (1915) 31 *T. L. R.* 531). The quorum provided for should be continuous all throughout the meeting of the directors. These articles usually are so framed as to give specific powers to the directors and thereafter to state that they may also exercise such other powers which either articles or the Act do not require the company exclusively as company to exercise, these articles would be operative (*In Re. Patent File Co.*, (1870) *L. R.* 6 *Ch. App.* 83; *In Re. Anglo Danubian S. N. & Colliery Co.*, (1875) *L. R.* 20 *Eq.* 339).

Directors' Personal Interest and Duties to Companies

Of course such powers as are given to the directors, must be exercised by them for the benefit of the company as they happen to be, to a certain extent, in the position

of trustees. Any abuse of power would bring in an intervention of the Court such as the wrongful exercise of a power to forfeit shares (*Richmond's Case,* (1858) 4 *K. & J. page* 305) or to make calls (*Gilbert's Case,* (1870) 5 *Ch. App.* 559); to refuse register of transfers (*Re. Gresham Life Assurance Society Ex parte Penny,* (1872) *L. R.* 8 *Ch. App.* 446). On the principle that the directors become agents of the company to a certain extent and act on behalf of the company as such, the agent cannot act where his interest happens to be in conflict with his duties. In this connection Ss. 91A, 91B, 91C, and 91D with the modifications effected by the Indian Companies (Amendment) Act 1936 are important. In case of a subordinate officer it has been held that when duty of investigating and ascertaining of fact is delegated to him in ordinary course of company's business the company would be bound by his knowledge in the same way as it is affected by the knowledge of the board of directors (*Evans* v. *Employers Mutual Insurance Co. Ltd.,* (1936) 1 *K. B.* 505).

With reference to the disclosure of interest by directors it is laid down that every director who is concerned or interested directly or indirectly in any contract or arrangement entered into by or on behalf of the company must disclose the nature of his interest at the meeting of the directors at which the contract or arrangement is determined on, if his interest there exists or in any other case at the first meeting of the directors after the acquisition of his interest or the making of the contract or arrangement. This is however subject to this that a general notice that the director is *a director or a member of any specified company or is a member of any specified firm,* and is to be regarded as interested in any subsequent transaction with such firm or company, shall be sufficient disclosure within the meaning of the Act as regards any such transaction. Thus after such general notice it shall not be necessary to give any special notice relating to any particular transaction with such firm or company [S. 91A (1)]. Any contravention of the above sub-section (1) will make

the directors concerned liable to a fine not exceeding rupees one thousand.

The other requirement of the same section happens to be that *every company shall keep a register in which it must enter particulars of all contracts or arrangements to which Sec. 91A (1) applies which register shall be open to inspection by any members of the company at the registered office of the company during business hours* [S. 91A (3)]. *Every officer of the company who knowingly and wilfully acts in contravention of the provision of Sec. 91A (3) is liable to a fine not exceeding rupees five hundred.* This particular provision which requires the register of contracts with the directors to be kept was inserted in response to the demand of the Bombay Shareholders' Association and the investing public to the effect that these contracts must be disclosed to the shareholders in order to enable them to find out the extent to which the directors of their company were interested in contracts with their company.

No director as a director shall vote on any contract or arrangement in which he is either directly or indirectly concerned or interested *nor shall his presence count for the purpose of forming a quorum at the time of any such vote* and if he does so vote, his vote shall not be counted. This is of course subject to the provision that the directors or any of them may vote on any contract of indemnity against any loss which they or any one or more of them may suffer by reason of becoming or being sureties or surety for the company [S. 91B (1)]. Every director who contravenes the provision of this Sec. 91B (1) is liable to a fine not exceeding rupees one thousand. The whole of this section 91B is not to apply to a private company *except that where a private company is a subsidiary of a public company, the section shall apply to all contracts or arrangements made on behalf of the subsidiary company with any person other than the holding company.* When one person is a director or an officer of two companies his personal knowledge is not necessarily the knowledge of both the companies. The knowledge which he has acquired as officer of one com-

pany will not be imputed to the other company unless he has some duty imposed on him to communicate his knowledge to the company sought to be affected by the notice, and some duty imposed on him by that company to receive the notice, and if the common officer has been guilty of fraud or even irregularity, the Court will not draw the inference that he has fulfilled these duties (*T. R. Pratt (Bombay) Ltd.* v. *E. D. Sassoon & Co. Ltd.*, (1935) 937 *Bom. L. R.* 978).

Where a company enters into a contract for the appointment of a *manager or managing agent* of the company in which contract any director of the company is directly or indirectly concerned or is interested or varies any such existing contract, the company shall within *21 days from the date of entering into the contract or the varying of the contract,* send an abstract of the terms of such contract or variation as the case may be, together with the memorandum clearly indicating the nature of the interest of the director in such contract, or in such variation, to every member and the contract shall be open to the inspection of any member at the registered office of the company. Any default in complying with this requirement will entail a fine not exceeding rupees one thousand on every officer of the company who knowingly and wilfully authorises or permits the default as well as on the company itself (S. 91C).

The other requirement of importance is that every manager or every agent of a company other than a private company *not being the subsidiary company of a public company* who enters into a contract for or on behalf of the company in which contract the company is an undisclosed principal, shall at the time of entering into the contract, make a memorandum in writing of the terms of the contract and specify therein the person with whom it has been made. Every such manager or every agent shall forthwith deliver the aforesaid memorandum to the company *and send copies to the directors,* and such memorandum shall be filed in the office of the company and laid

before the directors at the next directors' meeting [S. 91D (1 & 2)]. It should be noted here that the words "and send copies to the directors" have been now added to the old section. The object sought to be achieved by Sec. 91D which is a peculiarly Indian section is to prevent dishonest managing agents from saddling the company with their own transactions on the same turning out unprofitable. This section was originally introduced in the old Act because it was alleged that some managing agency firms which dealt in commodities such as cotton on their own account as cotton merchants, purchased cotton in their own name, but when the market fell and the transaction threatened to run into a loss, they allotted this transaction to the company which was running a cotton mill under their management, on the excuse that the said cotton was purchased by them in their own name on account of the cotton mill company concerned. It was thought that the section as originally framed for the old Act would effectively prevent such transactions if the managing agent or manager were to be forced to disclose the contract at the time the same was entered into, in case a memorandum in writing of its terms was placed before the directors at the next director's meeting. In practice however it was discovered that a large number of joint stock companies under managing agency system held their directors meetings at long intervals and in some cases only one or two meetings were held during a year. Thus it was decided that unless immediately on such contracts having been entered into copies of same were sent to directors, the object sought to be achieved by the section was frustrated. The section further imposes a fine not exceeding rupees two hundred in case of default of such manager or agent and in addition the contract itself is declared void as against the company [S. 91D (3)].

Notice of Board Meetings necessary

It is also compulsory that every time the directors meet, every member of the board has been given due notice

as to the meeting (*Portuguese Copper Mines, In re. Steele's Case*, (1889) 42 *Ch. D.* 160). If notice has not been given and one or more of the directors are absent in consequence, the proceedings would be invalid (*Harben* v. *Phillips*, (1883) 23 *Ch. D.* 14). Of course where a director has gone abroad, notice need not be given in the absence of express provision to the contrary (*Halifax Sugar Co.* v. *Francklyn*, (1890) 62 *L. T.* 564). There is one exception, however, as when all directors casually meet and agree to a meeting being held there and then waiving notice. Here the meeting will be good in spite of want of notice (*Barron* v. *Potter*, (1914) 1 *Ch.* 895; *Smith* v. *Paringa Mines, Limited*, (1906) 2 *Ch.* 193). It must be however remembered that whatever notice is given the same must be of a reasonable duration, and how far this duration is reasonable will be considered from the past practice applying to the particular company (*Browne* v. *La Trinidad*, (1887) 37 *Ch. D.* 1; *Homer Gold Mines, In re. Smith, ex parte*, (1888) 39 *Ch. D.* 546). If a board meeting is summoned on a very short notice the Court may, if it comes to the conclusion that the notice was too short and was purposely given with a view to exclude some directors, declare the notice bad (*Homer Gold Mines*, (1888) 39 *Ch. D.* 546)). The objection of course must be taken immediately by the party aggrieved. It is not necessary or compulsory to give particulars of business to be done at the meeting because it is thought that the directors as a select body are in duty bound to attend the meeting whenever they can (*La Compagnie De Mayville* v. *Whitley*, (1896) 1 *Ch.* 788; *Young* v. *The Ladies Imperial Club*, (1920) 2 *K. B.* 523). This rule of course will not apply where the articles require that the notice must state particulars. The articles usually provide that when the number of directors fall below the quorum the remaining shall act for the purpose of filling up the appointment and the continuing directors are sometimes allowed to do ordinary business meanwhile. In one case where the articles gave power to

directors to resign by a notice in writing and at a shareholders' meeting they offered to resign orally which was accepted, the Court held that the resignation was complete and they were restrained from attending the company's board meeting (*Latchford Premier Cinema, Ltd.* v. *Ermion*, (1931) 2 *Ch.* 409; *W. N.* 204).

Resolutions by Circulars

Frequently articles provide that a letter or resolution circulated among the directors and signed by them, approving the said resolution by the majority shall be binding. Whatever may be said as to the desirability of following such a procedure from the organisation standpoint, it is thought that such an article would be binding at law. Of course in the absence of such an article the directors cannot act without a meeting (*D'Arcy* v. *Tamar Hill Ry. Co.*, (1867) *L. R.* 2 *Ex.* 158; *Haycraft Gold Reduction Co.*, (1900) 2 *Ch.* 230). In the opinion of Lord Justice Fry, however, without a meeting the directors cannot think and that a collective opinion is contemplated by the Act, but unfortunately that does not seem to be the law (*Portuguese Copper Mines*, (1889) 42 *Ch. D.* 160).

With reference to powers given by the articles to directors the tendency of the Court is to give them as liberal a construction as possible (*Aberdeen Ry. Co.* v. *Blaikie*, (1854) 1 *Macq. H. L.* 461). Whatever be the powers as to carrying of business that may have been given to the directors, these powers do not include the fixing of their own remuneration, as we shall see later (*Foster* v. *Foster*, (1916) 1 *Ch.* 532).

The directors cannot appoint the managing director unless they are empowered to do so by the articles or by any general meeting (*Boschoek Proprietary Co.* v. *Fuke*, (1906) 1 *Ch.* 148 *at page* 159).

Forms of Articles as to Power of Directors

In connection with the powers of directors the articles give general powers in some clauses and specific powers in

others both in Indian and English Companies. The general powers are expressed more or less in the following terms :—

"The business of the company shall be conducted by the directors (with the assistance of the agents) in such manner as in their discretion they may think most expedient. They may pay all proper expenses incurred in getting up and registering and do all such acts and things as are by any Act of the Legislature, or by these presents, or by implication of law conferred upon the company, or directed or authorised to be done by it, and are not required to be exercised and done by the company in general meeting, but subject nevertheless to the provisions of any such Act of the Legislature or of these presents, and subject also to the provisions of the agreement, draft whereof is set forth in Schedule "A" hereto, (managing agents agreement) and to such regulations (if any) as may from time to time be prescribed by the company in general meeting; but no regulations made by the company in general meeting as aforesaid shall invalidate any prior act of the directors, which would have been valid if such regulations had not been made."

NOTE :—Where there is no managing agency the words "with the assistance of the agents" as well as "and subject also to the provisions of the agreement, draft whereof is set forth in Schedule 'A' hitherto" meaning thereby managing agents agreement may be omitted from this clause.

An alternative form is the following :—

"The management of the business of the company shall be vested in the directors, and the directors, in addition to the powers and authorities by these presents or otherwise expressly conferred upon them, may exercise all such powers and do all such acts and things as may be exercised or done by the company, and are not hereby or by law expressly directed or required to be exercised or done by the company in general meeting, but subject nevertheless to the provisions of the said Act and of these presents, and to any regulations from time to time made by the company in general meeting; provided that no regulation so made shall invalidate any prior act of the directors which would have been valid if such regulation had not been made."

One other alternative form, though comprising almost the same meaning is the following :—

"The management of the business of the company shall be vested in the directors and the directors may exercise all such powers and do all such acts and things as the company is, by its memorandum of association or otherwise authorised to exercise and do, and are not hereby or by statute directed or required to be exercised or done by the company in general meeting, but subject nevertheless to the provisions of the Act and of the memorandum of association and these articles and to any regulations not being inconsistent with the memorandum of association and these articles from time to time made by the company in general meeting; provided that no such regulation shall invalidate any prior act of the directors which would have been valid if such regulation had not been made.

Frequently the following words are added to the above articles where there is a managing agency incharge; " such of the powers as are entrusted to the agents from time to time shall be exercised by them."

Clauses as to specific powers

The specific powers given to the directors vary according to the terms and conditions under which the managing agents are appointed and in accordance with the nature of the company's constitution. Here it may be noted that many implied powers of directors under the Statute are expressly stated because directors are generally laymen and a specific statement as to these powers would be a guidance and thus of great assistance to them. Besides this, the shareholders generally are not very conversant with company law and the powers implied or expressed under the law, when exercised may create a wrong impression among them that the particular power exercised by the directors was *ultra vires*. It is also considered, by the best authorities, that the insertion of express powers relieves the directors from responsibility, because where such powers are given there will not be personal liability to the company in the absence of fraud or gross negligence. There are again third parties such as mortgagees, vendors, and other persons who are constantly in business relation with the company, who are also laymen

and thus it would be more easy to deal with them also in case the powers are expressly stated in the articles. The one additional advantage happens to be that here constant consultation with the company's or other lawyers by the parties concerned is thereby avoided. The usual practice of Indian Companies is to specifically state these powers more or less in the following form :—

"In furtherance, and not in limitation of, and without prejudice to the general powers conferred by these articles it is hereby expressly declared that the directors shall have the following powers :—

(*a*) They shall on behalf of the company forthwith adopt all arrangements and agreements made by the agents for the acquisition of land buildings and machinery for the company.

(*b*) They shall on behalf of the company forthwith enter into an agreement with the agents in the terms of the draft agreement set forth in the Schedule "A" to these articles and carry the same into effect with full power nevertheless to agree to any modification thereof.

(*c*) They shall on behalf of the company forthwith enter into an agreement with the brokers and muccadums in the terms of the draft agreement set forth in the Schedule "B" to these articles and carry the same into effect with full power nevertheless to agree to any modification thereof.

(*d*) They may purchase, take on lease, or otherwise acquire on account of and for the purposes of the company any property, rights, or privileges whatsoever, and may sell, improve, manage, develop, let, lease, dispose of, turn to account, or otherwise deal with such property, rights or privileges, on such terms as they shall think fit.

(*e*) They may take any conveyance, assignment or lease in the name of Trustees for the company, and may give the Trustees such indemnity as may be agreed upon.

(*f*) They may borrow on mortgage of the whole or any part of the property of the company or on the bonds, debentures, (either naked or secured by a charge or mortgage) notes or other securities of the company, or otherwise as they may deem expedient, such sums as they may think necessary for the purposes of the company.

(*g*) They may insure and keep insured against loss or damage by fire, or otherwise for such period and to such extent as they may think proper, all or any part of the buildings machinery, goods stores, produce, and other movable property of the company, either separately or conjointly; and may seal, assign,

surrender, or discontinue any policies of assurance effected in pursuance of this power.

(*h*) They may institute, conduct, defend, compound or abandon legal proceedings, and refer the same or any other dispute to arbitration.

(*i*) They may draw, issue, sign, accept, and indorse bills, hundis and promissory notes.

(*j*) They may notwithstanding anything herein contained, give to any director, officer or servant of the company, an interest in any particular business or transaction, or a participation in the profits thereof or in the general profits of the company in addition to or in substitution for a salary and such participation, commission or salary shall be treated as part of the working expenses of the company.

(*k*) They may place such part of the funds of the company as shall not be required to satisfy or provide for immediate demands either in current account or on deposit with any banker or any joint-stock company or may invest the same in or upon securities of or guaranteed by the Governnment of India or the Trustees of the Port of Bombay or the Municipal Corporation of the City of Bombay, and may from time to time vary such securities and investments and convert the same as occasion may require or as they may deem expedient.

(*l*) They may from time to time delegate to the agents such of the powers, exercisable by the directors as herein mentioned (except such as are expressly stated to be incapable of delegation), as they may deem advisable, and may delegate such powers for such time and to be exercised for such objects and purposes, and upon such terms as they consider expedient for the best interests of the company and the directors may delegate such powers either collaterally with, or to the exclusion of and in substitution for, all or any of the powers of the directors in that behalf, and may from time to time revoke or withdraw any such delegated powers, or alter or vary any of the conditions and restrictions aforesaid.

The following clauses are sometimes also added to the powers given above :—

(*m*) To pay the costs, charges and expenses preliminary and incidental to the promotion, formation, establishment and registration of the company.

(*n*) To commence business at any time after registration notwithstanding that part only of the shares may have been subscribed for or allotted.

(*o*) To pay for any property, rights or privileges acquired by or services rendered to the company, either wholly or partially,

in cash or in shares, bonds, debentures, mortgages or other securities of the company, and any such shares may be issued either as fully paid up or with such amount credited as paid up thereon as may be agreed upon; and any such bonds, debentures, mortgages or other securities may be either specifically charged upon all or any part of the property of the company and its uncalled capital or not so charged.

(*p*) To appoint any person or persons (whether incorporated or not incorporated) to accept and hold in trust for the company any property belonging to the company or in which it is interested, or for any other purposes, and to execute and do all such deeds and things as may be requisite in relation to any such trust, and to provide for the remuneration of such trustees.

(*q*) To make and give receipts, releases, and other discharges for money payable to the company, and for the claims and demands of the Company.

NOTE :—When managing agents are also given the power to grant receipts the following clause is also added :—

(*r*) A receipt signed by the agents, or any other person or persons especially authorised by the directors in that behalf, for any moneys, funds or property lent, or payable or belonging to the company, shall be an effectual discharge on behalf of and against the company for the moneys, funds or property which in such receipts shall be acknowledged to be received, and the person paying or delivering any such moneys, funds or property shall not be bound to see to the application, or be answerable for any misapplication, thereof.

(*s*) To determine from time to time who shall be entitled to sign on the company's behalf, bills, notes, receipts, acceptances, indorsements, cheques, dividend warrants, releases, contracts and documents and to give the necessary authority for such purpose.

The alternate clause given in connection with investing or dealing with the funds of the company is as follows:—

"To invest and deal with any moneys of the company not immediately required for the purposes thereof, upon such security or without security and in such manner as they may think fit, and from time to time to vary such investments."

When it is sought to give powers to directors to mortgage a property to a brother director who stands as a surety personally on behalf of the company the following clause is also added :—

(*t*) To execute in the name and on behalf of the company

in favour of any director or other person who may incur, or be about to incur, any personal liability whether as principal or surety for the benefit of the company, such mortgages of the company's property (present and future) as they think fit, and any such mortgage may contain a power of sale and such other powers, provisions, covenants and agreements as shall be agreed upon.

(*u*) To appoint, and at their discretion remove or suspend such managers, secretaries, officers, clerks, agents and servants, for permanent, temporary or special services as they may from time to time think fit, and to determine their powers and duties, and fix their salaries or emoluments, and to require security in such instances and to such amounts as they may think fit.

With regard to giving any officer or other person a commission on the profits of any particular business or transaction or a share in the general profits of the company the following is an alternate clause :—

"To give any officer or other person employed by the company, a commission on the profits of any particular business or transaction, or a share in the general profits of the company, and such commission or share of profits shall be treated as part of the working expenses of the company."

Powers are also given to the directors to subscribe to any charitable or other purpose, etc., by a clause such as the following :—

(*v*) To support and subscribe to any charitable or public object, and any institution, society, or club which may be for the benefit of the company or its employees, or may be connected with any town or place where the company carries on business; to give pensions, gratuities, or charitable aid to any person or persons who have served the company, or to the wives, children, or dependants of such person or persons, that may appear, to the director just or proper, whether any such person, his widow, children or dependants, have or have not a legal claim upon the company.

(*w*) Before recommending any dividend to set aside portions of the profits of the company to form a fund to provide for such pensions, gratuities or compensation; or to create any provident or benefit fund in such or any other manner as to the directors may seem fit.

The following is the power generally given for setting

aside out of profits depreciation reserve funds, etc., before declaring a dividend :—

(*x*) Before recommending any dividend to set aside out of the profit of the company such sums as they may think proper to form a depreciation fund for repairing, improving and maintaining any of the property of the company, a reserve fund to meet contingencies, a sinking fund to repay debentures or debenture stock or for special dividends or for equalising dividends and any other special fund for any other purposes, as the directors may, in their absolute discretion, think conducive to the interests of the company, provided that the amount set aside to form a depreciation fund shall be in the absolute discretion of the directors.

The power to declare dividend is more or less given in the following form :—

Dividends

(*y*) The directors may, with the sanction of a general meeting from time to time, declare a dividend, but no such dividend shall be payable except out of profits arising from the business of the company provided that when in the opinion of the directors, the profits of the company permit, they may in their discretion declare and pay by way of dividend on account, a half-yearly dividend. The dividend so declared shall be payable on all shares subject to the rights of the holders of shares created or raised under any special agreement as to dividend, in proportion to the amount of capital for the time being paid up in respect of such shares; provided, nevertheless, that where capital is paid up in advance of calls upon the footing that the same shall carry interest, such capital shall not, whilst carrying interest, confer a right to participate in profits.

The Power to deal with unclaimed dividends

The following is generally the article in connection with unclaimed dividends :—

(*z*) No dividend shall bear interest against the company and any dividend remaining unclaimed for four years from the declaration thereof, may be forfeited by resolution of the directors for the benefit of the company. But the directors may, at any time thereafter, if they shall so think fit, authorise the payment thereof to any claimant who shall adduce a title thereto the satisfaction of the directors.

Local Boards

Frequently powers have to be given to the directors to form local boards for managing any of the affairs of the company in any specified locality in India or out of India. This is done by a clause in the following form :—

From time to time and at any time to establish any local board for managing any of the affairs of the company in any specified locality in India or out of India and to appoint any persons to be members of such local board, and to fix their remuneration. And from time to time, and at any time to delegate to any person so appointed any of the powers, authorities, and discretions for the time being vested in the directors other than their power to make calls, and to authorise the members for the time being of any such local board or any of them, to fill up any vacancies therein and to act notwithstanding vacancies, and any such appointment or delegation may be made on such terms, and subject to such conditions as the director may think fit, and the directors may at any time remove any person so appointed, and may annul or vary any such delegation.

At any time and from time to time by power of attorney under the seal of the company to appoint any person or persons to be the attorney or attorneys of the company for such purposes and with such powers, authorities and discretions (not exceeding those vested in or exercisable by the directors under these presents) and for such period and subject to such conditions as the directors may from time to time think fit, and any such appointment may (if the directors think fit) be made in favour of the members or any of the members of any local board, established as aforesaid, or in favour of any company or of the members, directors, nominees or managers of any company or firm or otherwise in favour of any fluctuating body of persons, whether nominated directly or indirectly by the directors, and any such power of attorney may contain such powers for the protection or convenience of persons dealing with such attorneys as the directors may think fit, and may contain powers enabling any such delegates or attorneys as aforesaid to sub-delegate all or any of the powers, authorities and discretions for the time being vested in them.

Specific power to borrow

Frequently there is a special article giving in detail the specific power to borrow. The following is an all-embracing form of article :—

Without prejudice to the general powers conferred by the last preceding Article, and so as not in any way to limit or restrict those powers, and without prejudice to the other powers conferred by these presents, the directors shall have power from time to time at their discretion to accept deposits from members of the company either in advance of calls or otherwise and generally to raise or borrow or secure the payment of any sum or sums of money for the purposes of the company, provided that the total amount raised, borrowed or secured, and outstanding at any time shall not, without the sanction of the company in general meeting exceed the nominal amount of the capital, but so nevertheless that no depositor, lender or other person dealing with the company shall be concerned to see or inquire whether this limit is observed or not. The payment or repayment of such moneys may be raised or secured in such manner, and upon such terms and conditions in all respects as the directors may think fit, and in particular by the issue of debentures or debenture stock of the company charged upon all or any part of the property of the company (both present and future) including its uncalled capital for the time being; and debentures, debenture stock, and other securities may be made assignable free from any equities between the company and the person to whom the same may be issued.

Frequently a clause is added giving the directors the power to refer matters to arbitration as follows :—

To refer any claims or demands by or against the company to arbitration and to observe and perform their award according to the terms of the Indian Arbitration Act of 1899.

NOTE :—Section 152 of the Indian Companies Act of 1913 gives this power to the companies to refer matters to arbitration.

In this connection it should be noted that an article providing for reference of disputes between a company and its members is a sufficient submission in writing within the Arbitration Act (*Hickman* v. *Kent or Romney Marsh Sheep-Breeders' Association,* (1915) 1 *Ch.* 881). In this case the wording of the Arbitration Clause has to be as follows :—

Whenever any difference arises between the association and any of the members touching the true intent or construction or the incidents or consequences of these presents or of the statutes, or touching anything then or thereafter done, executed, omitted, or suffered in pursuance of these presents or of the statutes, or

touching any breach or alleged breach of these presents, or any claim on account of any such breach or alleged breach, or otherwise relating to the premises or to these presents, or to any statute affecting the association, or to any of the affairs of the association, every such difference shall be referred to the decision of an arbitrator to be appointed by the parties in difference, or, if they cannot agree upon a single arbitrator, to the decision of two arbitrators of whom one shall be appointed by each of the parties in difference, or any umpire to be appointed by the two arbitrators. And upon every or any such reference the costs of and incident to the reference and award respectively shall be in the discretion of the arbitrators, or umpire respectively, who may determine the amount thereof, or direct the same to be taxed as between solicitor and client or otherwise, and may award by whom and to whom and in what manner the same shall be borne and paid, and such decision shall be made in order of the High Court of Justice upon the application on either party.

Provision for welfare of employees, etc.

Frequently there is a clause in the articles empowering the directors to provide for dependents, etc., which is as follows :—

To provide for the welfare of the employees or ex-employees of the company, and the wives, widows, and families, or the dependents or connections of such persons, and to give, award, or allow any pension, gratuity, compensation, grants, or money, allowances, bonus or other payment to or for the benefit of such persons, as may appear to the directors just and proper, whether they have or have not a legal claim upon the company, and, before recommending any dividend, to set aside portions of the profit of the company to form a fund to provide for such payments, and in particular to provide for the welfare of such persons, by building or contributing to the building of houses, dwellings or chawls, or by creating, and from time to time subscribing, or contributing to provident and other associations, institutions, funds or trusts, or providing or subscribing or contributing towards places of instructions and recreation, hospitals and dispensaries, medical and other attendance, and such other assistance as the directors shall think fit, and to subscribe or contribute, or otherwise to assist or to guarantee money to charitable, benevolent, religious, scientific, national or other institutions, or objects which shall have any moral or other claim to support or aid by the company, either by reason of locality of operation, or of public and general utility, or otherwise.

Power to make Bye-laws

A clause in the article is some times found giving the directors the power to make bye-laws. There is no doubt that these bye-laws could only be made in connection with the internal office rules and regulations, such as for officers and servants of the company if they are to be made and varied by the board of directors. If however this clause empowers the directors to make and vary bye-laws applicable to the "members" of the company also that would be *ultra vires* the Board of Directors, because that would amount to adding or altering of articles of association which under the Act can only be done by a special resolution of the company. Thus if such an article were to be framed in connection with bye-laws it should take the following form :—

> From time to time to make, vary, and repeal bye-laws for the regulation of the business of the company, its officers and servants.

In England the registrar of companies, in case of such an article being inserted in the articles of association, enforces that the following provision should be added before they are taken on the file :—

> Provided that no bye-laws or regulation shall be made under this power which would amount to such in addition to or alteration of these articles as could only legally be made by special resolution passed and confirmed in accordance with Secs. 20 and 81 of the Indian Companies Act, 1913.

DUTIES OF DIRECTORS

Duties as imposed by the Act

The Indian Companies Act throws on directors numerous duties and responsibilities in common with the officers of the company under various sections and also provides in most cases penalties for default. These duties may be summarised according to the following table :—

LIST OF OFFENCES UNDER THE INDIAN COMPANIES ACT, 1913 WITH THE MAXIMUM PENALTIES THEREFOR

NOTE :—Deep black "**F**" indicates offences for omission to file by the Company Officers, documents for the facility of reference.

SECTION.	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
4.	Omission to incorporated as a company carrying on a banking business with more than ten persons or carrying on other business with more than twenty persons.	*Every member of a company, association or partnership.*	*Rs. 1,000*
25.	Not sending copies of memorandum and articles at their request within fourteen days.	Company.	Rs. 10 for each offence.
25(A).	*Default in issuing copies of memorandum and articles not in accordance with alteration made.*	*Company and every officer who knowingly and wilfully in default.*	*Rs. 10 for each copy so issued.*
31.	Omission to keep in one or more books a register of members and to enter therein particulars as required by the Act as enumerated in the section.	Company and every officer who knowingly and wilfully authorises the default.	Rs. 50 for every day during which the default continues.
31(A).	*Failure to maintain an index of members or to keep the register of members in a form as would constitute an index.*	*Company and every officer who knowingly and wilfully in default.*	*Rs. 50.*

Section.	Nature of Offence.	Persons Liable.	Penalty.
32.	Default in getting prepared and filed annual list of members and summary with particulars. **F.**	*Company and every officer who knowingly and wilfully in default.*	Rs. 50 for every day during which the default continues.
34(4).	*Failure to register transfer or sending notice of refusal of transfer within two months from the date on which the instrument of transfer was lodged.*	*Company and every director, manager, secretary or other officer who is knowingly a party to the default.*	Do.
36.	Refusing to grant inspection or copy of register of members to members gratis and to any other person on payment of Re. 1 or less for each inspection. *Any such member or other person may make extracts. If copy is required the same must be sent within ten days exclusive of non-working days.*	*Company and every officer who is in default.*	*Rs. 20 for each offence and to a further fine not exceeding Rs. 20 for every day during which the default or refusal continues and the Court may order inspection to be given immediately.*

Section.	Nature of Offence.	Persons Liable.	Penalty.
41.	Default in filing notice of situation of the office where British Register is kept and of change in situation or discontinuance (within one month). **F.**	Company.	Rs. 50 for every day during which the default continues.
47.	Failure to enter in the register of members when share warrants are issued, the fact of such issue and to strike off the name of the member concerned.	Company and every officer who knowingly and wilfully continues or permits the default.	Rs. 50 for every day during which the default continues.
51.	Failure to file within fifteen days, notice with the Registrar on consolidation or division of share capital, or conversion of shares into stock and re-conversion. **F.**	Do.	Do.
53.	Failure to file with the Registrar notice of increase of share capital or of members within fifteen days after passing the resolution or confirmation of special resolution. **F.**	Do.	Do.
54(A).	*Contravening restrictions by the company to purchase its own shares directly or indirectly in connection with purchase made or loans granted.*	Do.	*Rs. 1,000.*

SECTION.	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
62.	Failure to embody the minute of reduction of capital in the relevant part of the Memorandum of Association issued after registration of such minute.	Do.	Rs. 10 for each copy issued.
64.	Officer concealing the name of any creditor entitled to object to reduction of capital or wilfully misrepresent the nature of the amount of the debt or claim of the creditor.	Any officer of the company who wilfully commits the offence.	Imprisonment up to one year with or without fine or both.
66(A).	*Failure to send to the registrar the copy of an order of the Court on application by dissenting shareholders on a variation at a class meeting within fifteen days after service.* **F.**	*Company and every officer who knowingly and wilfully in default.*	*Rs. 50.*
70.	Default in adding a statement as to unlimited liability of a director or proposer for his election or when giving him notice in writing before he accepts office as to his unlimited liability.	Director and officer or proposer or promoter.	*Rs. 1,000 and damages.*

SECTION.	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
72.	*A company carrying on business without a registered office of failure to give the notice of situation or of change of situation within twenty-eight days to the Registrar.* **F.**	Company.	*Rs. 50 for every day during which the default continues.*
74(1).	Default by a limited company to affix or paint its name outside every office or place of business and on its seal.	Company and every officer who knowingly and wilfully authorises or permits the default.	Do.
74(2).	Using seal without engraving on it the company's name or issuing bill heads, letter-paper and other official publications for signing Hundis, cheques, etc., wherein the name of the company is not mentioned.	Any officer of the company who commits the offence.	Rs. 500.
75.	Default in publishing authorised as well as subscribed and paid-up capital amounts wherein notice or other publication contains a statement of the amount of authorised capital.	Company and every officer who knowingly a party to the default.	Rs. 1,000.

Section.	Nature of Offence.	Persons Liable.	Penalty.
76.	*Failure to hold a general meeting within eighteen months from the date of incorporation and thereafter once at least in every calendar year and not more than fifteen months after the last preceding general meeting.*	Do.	Rs. 500.
77.	*Failure to hold a statutory meeting after one month and within a period of six months from the date when the company is entitled to commence business and to send the Statutory Report at least twenty-one days before the date of the meeting to every member and every person entitled to receive it.*	*Every director who knowingly and wilfully authorises or permits the default in each case, viz., that of holding a meeting or forwarding the report, etc.*	Do.
82(1).	Failure to get filed with the registrar a printed or typewritten copy of a special or extraordinary resolution within the prescribed time. **F.**.	Company.	Rs. 20 for every day during which the default continues.
82(2).	Default in embodying in or annexing to every copy of the Articles, copy of a special resolution or in forwarding same in print to a member.	Company and every officer who knowingly and wilfully authorises or permits the default.	Rs. 10 for each copy.

SECTION.	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
83.	*Refusing inspection of minute book of general meetings during business hours to a member or after seven days of the meeting of the company refusing to supply on demand to a member copies of the minutes at a charge not exceeding six annas for every hundred words.*	Do.	*Rs. 25 for each offence and a further fine not exceeding Rs. 25 for every day of default.*
84(2).	Including in a list of persons who have consented to be directors of the company, a name of any person who has not so consented.	Applicant for registration of the company.	Rs. 500.
85.	Acting as a director without acquiring qualification after two months have expired since appointment.	Any unqualified person who acts as a director.	Rs. 50 for every day.
86(A).	*An undischarged bankrupt acting as a director, manager or managing agent of a company.*	*Undischarged bankrupt acting as a director.*	*Imprisonment for a term not exceeding two years or to a fine not exceeding Rs. 1,000 or both.*

SECTION.	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
86(D).	*Making any loan or guaranteeing any loan made to a director or to a firm of which such director is a partner or to a private company of which such director is a director.*	*Any director who is a party to such contravention.*	*Rs. 500. and joint and several liability for the amount unpaid.*
87.	*Default in keeping the register of directors, managers and managing agents containing required particulars which must be open for inspection during business hours and filing within fourteen days with the registrar a copy thereof with the notice of any change from time to time.* **F.**	*Company and every officer who knowingly and wilfully in default.*	*Rs. 50*
87(D).	*Making or guaranteeing any loan out of company's money to a managing agent or to any partner of managing agency firm or to a director of a private company, if the managing agent is a private company.*	*Director who is a party to such loan or guarantee.*	*Rs. 500. and joint and several liability for amount unpaid.*
87(E).	*Making any loan to or guaranteeing any loan made to any company under management by the same managing agent.*	*Director and officer who knowingly and wilfully in default.*	*Rs. 1,000. and joint and several liability for loss incurred.*

SECTION.	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
91(A).	Failure to disclose by the director of his interest in the contract or arrangement to the Board of Directors and default in maintaining *a register giving particulars of all contracts or arrangements with directors which must be open for inspection by a member of the company at the registered office.*	*Every officer of the company who knowingly and wilfully acts in contravention.*	Rs. 1,000 on the director who makes the default. *and Rs. 500 on the every officer.*
91(B).	Voting in case of a public company on a resolution by interested directors as a director or counting the presence of such directors in quorum.	Every director who violates the provisions of this section.	Rs. 1,000.
91(C).	Default in sending an abstract of the contract *within twenty-one days from the date of entering into same or of the varying of the contract* for the appointment of a manager including managing agent of the company in which contract any director is directly or indirectly interested to every member or any variation in it.	Company and every officer who knowingly and wilfully authorises or permits the default.	Rs. 1,000.

SECTION.	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
91(D).	Default of every manager or agent including managing agent of a company (*other than a private company not being the subsidiary company of a public company*), entering into contract for or on behalf of the company in which the company is an indisclosed principal, or delivering the memorandum of the terms of such contract *and sending copies of same to directors* at the time of entering into the contract specifying the person with whom it was made.	Manager or agent who makes the default.	Rs. 200. and the contract at the option of the company shall be void against the company.
92.	In case of a public company failing to file with the registrar a copy of the prospectus before issuing same. **F.**	Company and every person who is knowingly a party to the default.	Rs. 50 for every day from the date of issue of prospectus until the copy is filed.
96.	*To issue any form of application for the shares in or debentures of a company unless the form is issued with the prospectus according to S. 93.*	*Any person issuing.*	Rs. 500.

Section.	Nature of Offence.	Persons Liable.	Penalty.
97.	*Issuing prospectus not in compliance with requirements of S. 93.*	*Every person who is knowingly responsible for the issue.*	*Rs. 50 for every day from the day of issue until a copy complying is filed.*
98(A).	*Failing to file with registrar, as a prospectus under Section 92, any document offering shares or debentures for sale and default in including in such documents the required particulars as in a prospectus.*	*Every person responsible for issue.*	*Rs. 50 for every day during which the default continues.*
101.	Failure to deposit and keep deposited *all money received from applications for shares, in a scheduled bank until returned or certificate of commencement is obtained.*	*Promoter, director or other person responsible.*	*Rs. 500 if money not kept in a scheduled bank as required* and to pay interest at 7 per cent. per annum from the expiration of the time.
103.	Commencing business before all requirements of the section are complied with.	Every person who is responsible for the contravention.	Rs. 500 for every day during which contravention continues.

SECTION	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
104	Default in filing a return of allotment within one month and to produce for inspection to the registrar contract for fully or partly paid shares which the return refers to. **F.**	Every officer of the company who is knowingly a party to the default.	Rs. 500. for every day during which the default continues.
105(A) (2).	*Failure to state in every prospectus and every balance-sheet issued by a company which has issued shares at a discount, particulars of discount allowed or of so much of that discount as has not been written off at the date of the document.*	*Company and every officer who is in default.*	Rs. 50
105(B) (2)	*Failure to include in every balance sheet of a company which has issued redeemable preference shares, a statement specifying what part of the issued capital is made up of such shares and the date of redemption.*	*Company and every officer who is in default.*	*Rs. 1,000*
108(2).	Default in issue of certificates.	Company and every officer who is knowingly a party to the default.	Rs. 50. for every day during which the default continues.

SECTION.	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
109(A).	*Failure to register purchase of a property after the Amending Act of 1936 with a charge or mortgage of a class which requires registration if charge was created by the company itself.* **F.**	*Company and every officer who is knowingly and wilfully in default.*	*Rs. 500.*
118(2).	Default in registration of appointment of receiver. **F.**.	Person who has obtained the order for appointment of receiver or who has appointed a receiver under any power.	Rs. 50 for every day during which the default continues.
119(2).	*Where a receiver of the property of the company is appointed, failure to state in every invoice order for goods or business letter issued by on behalf of the company, the fact of the appointment of the receiver.*	*Company and every director, manager, managing agent, secretary, or other officer of the company* and every receiver who knowingly and wilfully authorises or permits the default.	*Rs. 200.*

Section.	Nature of Offence.	Persons Liable.	Penalty.
122(1).	Failure to file with the registrar for registration particulars of any mortgage or charge created by the company *or of payment or satisfaction of a debt in respect of which a mortgage or charge has been registered under S. 109 or S. 109(A) or issue of debentures of a series requiring registration.* **F.**	Company and every officer or other person who is knowingly a party to the default.	Rs. 500 for every day of default.
122(2).	Default in complying with any of the requirements of the Act as to the registration with the registrar of any mortgage or charge created by the company.	Company and every officer who knowingly and wilfully authorises or permits the default.	Rs. 1,000.
122(3).	Authorising or permitting delivery of debenture or certificate or debenture stock requiring registration without a copy of the certificate of registration being endorsed on it.	Any person knowingly and wilfully authorises or permits the default.	Rs. 1,000.
123.	Omission to keep register of mortgages or charges *and enter therein charges and mortgages and all floating charges on the undertaking or on any property of the company.*	Any director, manager, or other officer knowingly and wilfully authorises or permits the default.	Rs. 500

SECTION.	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
124.	Refusal to grant inspection of instrument creating mortgage or charge and requiring registration or register of mortgages and charges.	Company and every officer knowingly and wilfully authorises or permits the default.	Rs. 50 for refusal and Rs. 20 for every day of default.
125.	Refusing inspection to a debenture-holder or shareholder, of the register of holders of debentures and refusing or refusing to forward a copy of the trust deed to every debenture-holder if required on a payment not exceeding Re. 1.	Do.	Do.
130.	*Failure to keep books of accounts as required by this section.*	*Managing agent, partners of the firms of managing agents or directors of the managing agent and in any other case director or directors knowingly and wilfully guilty of the omission.*	*Rs. 1,000*
131(A).	*Directors failure to make out and attach to every balance sheet a report in respect of the state of affairs of the company, etc.*	*Any person being a director who is knowingly and wilfully guilty of a default.*	*As in the above case under Sec. 130.*

SECTION.	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
133.	Default in laying before the company or in issuing the balance-sheet *or profit and loss account or income and signed by* requisite num- *expenditure account* ber of officers and directors as provided in the section in case of banking and other companies before issuing same	*Company and every officer including the director who was knowingly a party to the default for not placing a balance-sheet and profit and loss account before the company as required by Sec. 131 or where the balance-sheet or profit and loss account is issued and circulated or published which does not comply with Secs. 131, 132, 132A. and 133.*	*Rs. 500.*
134.	Failure to file the balance sheet and profit and loss account with the registrar *after* being laid before the company at the same time as annual list as per S. 32. If the general meeting does not adopt the balance sheet that fact with reasons must be annexed to the balance sheet. F..	Company and every officer who knowingly and wilfully authorises or permits the default.	Penalty same as provided in S. 32 for default of provisions of that section.

Section.	Nature of Offence.	Persons Liable.	Penalty.
136.	Default in case of Banking, Insurance or Provident Company to display a statement *together with a copy of the last audited balance-sheet laid before the members of the company* in a conspicuous place of business according to Form G, and to furnish copy thereof to every member or creditor on payment of a fee not exceeding annas eight.	Do.	Rs. 50 for every day during which the default continues.
137.	Refusing or neglecting to supply information or explanation to the registrar as to any document or to submit a document when required from persons who are or have been officers of the company.	Officers of the company who commits the fault.	*Rs. 50 for each offence.*
140.	Refusing to produce all books and documents in their custody by the officers of the company to the inspector appointed by Local Government to investigate the affairs of the company and refusing to answer his questions.	Any person refusing.	Rs. 50 for each offence.

Section	Nature of Offence.	Persons Liable.	Penalty.
142.	Refusing to produce book or document or answering questions to the inspector appointed by special resolution of the company.	Every officer of the company who commits the default.	Do.
145.	*Auditor making his report without complying with the provisions of this section.*	*Every auditor who is knowingly and wilfully a party to the default.*	*Rs. 100.*
147.	Carrying on business with fewer than seven in case of public or two in private company for more than six months.	Every person who is a member of the company.	Severally liable for payment of all the debt contracted during that time.
153(3).	*Default in filing a certified copy of an order made by the Court under Sec. 153(2) with registrar, and omission to annex a copy of the order to every copy of the memorandum of the company issued thereafter.* **F.**	*Company and every officer who is knowingly and wilfully in default.*	*Rs. 10 for each copy so issued.*
153(A).	*Default in filing a certified copy of the order made under this section with the registrar.* **F.**	Do.	*Rs. 50.*

Section.	Nature of Offence.	Persons Liable.	Penalty.
154.	*In case of conversion of a private into a public company, failure to file with the registrar a prospectus or a statement in lieu of prospectus within fourteen days of the conversion.* **F.**	Do.	*Rs. 500.*
177(A).	*In case of winding up by the Court default in preparing and submitting, by the directors of a statement to the liquidator as provided for by that section.*	*Any person knowingly and wilfully makes default in complying with the requirements of this section.*	*Rs. 100 for every day during which the default continues.*
194(3).	Official liquidator not filing with registrar Court's order of dissolution. **F.**	Official liquidator making default.	Rs. 50 for every day during which the default continues.
206.	Default in publishing notice of resolution for winding up of a company voluntarily in the local official gazette and in some newspaper circulating in the district of the registered office.	Company and every officer who knowingly and wilfully authorises or permits the default.	Do.
208(D).	*Liquidator's failure to summon a general meeting and laying before it an account and statement showing the position of the liquidation.*	*Liquidator failing to comply.*	*Rs. 100.*

SECTION.	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
208(E).	*Failing to file with the registrar a certified copy of the order for registration of the account of the liquidator in winding up.*	*Person on whose application an order was made.*	*Rs. 50 for every day of default.*
209(A).	*Default by the company in calling a meeting of the creditors and by directors to lay advertising the notice of such meeting; default before the creditors' company's affairs and meeting a full statement of the position of the to appoint one of them to preside at such meeting, and the default of the director appointed to preside the meeting of the creditors in attending and presiding thereat.*	*Company director or directors as the case may be, and every officer of the company who is in default.*	*Rs. 1,000.*
209(G).	*Failure by liquidator to call a meeting of the company and creditors at the end of first year and of each succeeding year of liquidation.*	*Liquidator.*	*Rs. 100.*
209(H).	*Failing to file the Court's Order deferring the liquidation of the company.*	*Person on whose application the order was made.*	*Rs. 50. for every day of default.*
214.	*Failure by liquidator to register a notice of his appointment in voluntary liquidation.*	*Liquidator.*	Do.

SECTION.	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
235.	Misapply or to retain or be liable or accountable for money or property or be guilty of misfeasance or breach of trust.	Director, manager, liquidator, and other officer.	Damages and compensation for all losses in addition to criminal liability.
236.	To mutilate or alter or falsify books, papers or securities of the company.	Any director manager, officer or contributory.	Imprisonment up to seven years and also to a fine if proved in winding-up.
237.	Prosecution of delinquent directors proved for at expense of the Crown.		
238.	Failure to give true evidence in or about the winding up of a company.	Any person.	Imprisonment for a term of seven years, and also fine.
238(A).	*Embraces numerous penal provisions.*		
243.	Failure to file with the registrar a certified copy of the order of the Court declaring dissolution void within twenty-one days.	Person on whose application the order was made.	Rs. 50 for every day of default.

SECTION.	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
244.	Failure to file liquidator's statement once every year in Court or with registrar as the case may be containing prescribed particulars with respect to the proceedings in and position of the liquidation.	Liquidator.	Do.
244(A).	*Failure to pay in liquidation the money received by the liquidator in a scheduled bank within ten days*	*Liquidator.*	*He shall pay interest on the amount retained in excess at 21 per cent. per annum and may be disallowed all or part of his remuneration by the Court, and may be removed and made to pay expenses occasioned by the default.*
249(A).	*Enforcing submission of return and documents to registrar under any provisions of this Act requiring such filing.* **F.**	*Company and any officer responsible.*	*Cost of application to be borne by the company or the officer responsible.*

SECTION.	NATURE OF OFFENCE.	PERSONS LIABLE.	PENALTY.
277.	Requirement as to companies established outside British India.	Company and every officer or agent responsible.	Rs. 50 for every day during which the default continues.
277(A-B).	*Issue circulation or distribution in British India of a prospectus offering shares or debentures for subscription of a company outside British India in contravention of these Sections.*	*Any person knowingly responsible.*	*Rs. 5,000.*
277(C).	*House to house canvassing of shares of a company incorporated outside India.*	*Any person contravening the section.*	*Rs. 100.*
277(G).	*Restriction on use of the words Bank, Banker and Banking on companies formed after commencement of Indian Companies (Amendment) Act, 1936.*	*Director or officer.*	*Rs. 500.*
277(H).	*Restriction on Banking company employing managing agent.*	Do.	Do.
277(J).	*Prohibition of charge on unpaid capital of a Banking company.*	Do.	Do.
277(K).	*Provision compelling banks to create and maintain a reserve fund as provided in the section.*	Do.	Do.

Section.	Nature of Offence.	Persons Liable.	Penalty.
277(L).	*Maintenance by way of cash reserve as provided in the section.*	Do.	Do.
277(M).	*Restriction on nature of subsidiary companies.*	Do.	Do.
282.	False statements in returns or documents.	Whoever may commit the offence.	Fine and imprisonment of either description for a term which may extend to three years.
282(A).	*Wrongfully obtaining possession of property of a company or withholding it if in his possession.*	*Director, manager, agent, officer or employee.*	*Rs. 1,000*
	Failing to deliver or refund the said property within time fixed by the Court.	Do.	*Imprisonment up to two years.*
282(B).	*Misapplication of securities by employees.*	*Director, managing agent, or officer.*	*Rs. 500.*
283.	Improper use of words "limited."	Any person trading or carrying on business without incorporation as limited liability company.	Rs. 50. for every day of default.

With reference to duties of directors their status ought to be considered and in this connection the Act does not attempt to give the precise definition but as decided in *Forest of Dean Coal Mining Co.*, (1879) 10 *Ch. D.* 451, by Jessel, M. R.:—" Directors have sometimes been called trustees or commercial trustees, and sometimes they have been called managing partners, it does not matter much what you call them so long as you understand what their true position is, which is that they are really commercial men managing a trading concern for the benefit of themselves and of all the other shareholders in it. They are bound, no doubt, to use reasonable diligence having regard to their position, though probably an ordinary director, who only attends at the board occasionally, cannot be expected to devote as much time and attention to the business as the sole managing partner of an ordinary partnership, but they are bound to use fair and reasonable diligence in the management of their company's affairs, and to act honestly."

Directors as Trustees

The next position of the directors is that of a resemblance to that of a trustee in connection with the assets of the company which come into their hands (*In Re. Lands Allotment Co.*, (1894) 1 *Ch. D.* 616). According to *Lord Hardwick* (*Charitable Corporation* v. *Sutton*, (1742) 2 *Atk.* 400) directors of a chartered corporation who have misapplied its funds and committed breaches of its bye-laws, were liable as trustees for "breach of trust." *Lord Hardwick* came to the same decision in *York & North Midland Rail Co.* v. *Hudson,* (1853) 16 *Beav.* 485 and held that directors who had dealt with the funds of the company improperly were liable as trustees. *Lord Selbourne* in *Great Eastern Railway Co.* v. *Turner*, (1873) 8 *Ch. App.* 149 laid down that, "the directors are the mere trustees or agents of the company—trustees of the company's money and property; agents in the transactions which they enter into on behalf of the

company." The same principle is laid down in *Alexander* v. *Automatic Telephone Co.,* (1900) 2 *Ch. D.* 56, where *Lindley M. R.* laid down that "the Court of Chancery has always exacted from directors the observance of good faith towards their shareholders and towards those who take shares from the company and become co-adventurers with themselves and others who may join them. The maxim "*caveat emptor*" has no application to such cases, and directors who so use their powers as to obtain benefits for themselves at the expense of the shareholders without informing them of the fact, cannot retain those benefits and must account for them to the company, so that all the shareholders may participate in them." It is, however, further held in another case that the relation of trusteeship exists as between the company and the directors, but not as between the directors and individual shareholders (*Percival* v. *Wright,* (1902) 2 *Ch.* 421). Section 91A of the Indian Companies Act requires every director directly or indirectly concerned or interested in any contract, or arrangement, entered into by, or on behalf of the company, to disclose the nature of his interest, if any, at the meeting of directors at which the contract or arrangement was determined if his interest then exists, and in case the director had no interest at such a time, but acquire interest later on, he is required to disclose such interest at the first meeting held immediately after a notice to the effect that this particular director is a *director or a member of any specified company or is a member of any specified firm,* with whom the said transaction is entered into, then the said notice shall be sufficient. Any contravention of the requirement of this section makes the director liable to a fine not exceeding one thousand rupees. The new Amendment Act of 1936 also requires that *a register shall be kept by the company in which shall be entered particulars of all the abovenamed contracts or arrangements with the directors. This register shall be open to inspection by any member of the company at the registered office of the company during business hours. Every officer*

of the company who knowingly and wilfully acts in contravention of these provisions shall be liable to a fine not exceeding five hundred rupees [Sec. 91A (3) (4)]. It may be added here that according to Sec. 86F the Amended Act provides that these contracts *for the sale, purchase or supply of goods and materials* with the company *cannot be entered into except with the consent of the directors.* This rule of law applies only to contracts entered into after the commencement of the Amending Act of 1936. The director is also prevented by Sec. 91B from voting on such a contract at the meeting when it is considered by his brother directors, *and his presence shall not be counted for the purpose of forming a quorum at the time of any such vote* and in case he does so, not only his vote will not be counted, but he is liable to be fined to the extent of one thousand rupees. This rule under Sec. 91B does not apply to a private company *provided that where a private company is a subsidiary company of a public company this section shall apply to all contracts or arrangements made on behalf of the subsidiary company with any person other than the holding company.*

To Sections 91A and 91B, as we have noticed, make it compulsory that the interest of a director should be disclosed by him and that he should refrain from voting on a proposition when contract in which he has interest is being considered, except where "it is a contract of indemnity against any loss which they or any one or more of them may suffer by reason of becoming or being sureties or surety for the company." These Sections do not, however, in any way abolish the well-established rule of law that unless authorised by articles, the directors cannot enter into contract with their companies, because "a director of a company is precluded from dealing on behalf of the company with himself, and from entering into engagements in which he has a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound by fiduciary duty to protect,

and this rule is as applicable to the case of one of several directors, as to a managing or sole director. Any such dealing or engagements may, however, be affirmed or adopted by the company provided such affirmation or adoption is not brought about by unfair or improper means and is not illegal or fraudulent or oppressive towards those shareholders who oppose it" (*North West Transportation Co.,* v. *Beatty,* (1887) 12 *App. Ca.* 589 *at page* 593). The idea underlying being to preclude a person from placing himself in a position in which his duty and interest are in conflict (*Parker v. McKenna,* (1875) 10 *Ch.* 96-118).

The modern articles generally contain clauses empowering directors to enter into contracts with their company after making due disclosure of same to their fellow directors which of course is quite legal and proper. In the absence of such a clause in the articles the director at fault would have to account for all the profits made by him on such a contract to the company unless the contract is ratified by the company (*Grant* v. *U. K. Switchback Ry. Co.,* (1889) 40 *Ch. D.* 138). In such a case or in any other case of secret profit, however, the company itself is the proper person to sue (*Clarkson v. Davies,* (1923) *A. C.* 100). It must be noted however that where the articles permit the directors to contract as above after disclosing interest, the quorum at the board meeting should be counted by excluding the interested director (*Greymouth Point Elizabeth Ry. & Coal Co.,* (1904) 1 *Ch.* 32). If on the other hand the articles do not contain the power authorising a director to enter into contracts with the company, it has been held that even the rest of the board, *i.e.,* those who are not interested, cannot vote and give effect to such a contract as the company has the right to get an unbiased opinion of the whole board (*Benson* v. *Heathorn,* (1842) 1 *Y. & C. C. at pp.* 341-42) also (*Imperial Mercantile Credit Assn.* v. *Coleman,* (1871) *L. R.* 6 *Ch. App.* 558).

The directors are no doubt in some sense trustees of

the company and are to be held liable as such where the nature of the transaction has appeared to the Court to be such as to make the directors so liable. They are such trustees and agents for the shareholders of the powers committed to them and it is on this principle that directors are not allowed to vote in a matter which is the subject of discussion at a board meeting in which they are personally interested, *i.e.*, where their interest conflicts with their duties (*Ramaswami Iyer v. The Madras Times Co.*, (1915) 38 *Mad.* 991). It is however held that, they are not trustees, and liable as such in every case, simply because they are acting as directors of the company, and the distinction between the two positions, *viz.*, that of agents and trustees respectively, which they are from time to time called upon to fill, is fully dealt with by *James L. J.* in *Smith* v. *Anderson,* (1880) 15 *Ch. D.* 247. To take an illustration, directors are not trustees for individual shareholders and thus they may buy shares of a member in spite of the fact that as directors they are aware that the value of these shares is likely to be enhanced through certain negotiations they are carrying on, though it may be that they may be accountable for the profits so made to the company (*Percival v. Wright,* (1902) 2 *Ch.* 421; *Nugent* v. *Nugent,* (1908) 1 *Ch.* 546). On the same footing directors are not trustees of the applicants of shares or for creditors of the company (*Brown* v. *Stewart,* (1898) 1 *Fraser* 316; *Noction* v. *Ashburton,* (1914) *A. C.* 932 *at p.* 955; *Wilson* v. *Lord Bury,* (1880) 5 *Q. B. D.* 518). This is so even though the company may be in fiduciary relationship with the creditor (*Bath* v. *Standard Land Co.,* (1911) 1 *Ch.* 618). It has also been held that even where the directors are given as a present the qualification shares and there has been a full disclosure of it in the prospectus or to the company as a whole, the directors will not be accountable (***Postage Stamp Automatic Delivery Co.,*** (1892) 3 *Ch.* 566; ***Lagunas Nitrate Co.*** v. ***Lagunas Syndicate,*** (1899) 2 *Ch.* 392; ***British Seamless Paper Box Co.,*** (1881) 17 *Ch. D.* 467;

Innes & Co., (1903) 2 *Ch.* 254). Here directors will not be placed on the list of contributories (*Carling's Case,* (1876) 1 *Ch. D.* 115). Money presents from promoters to directors out of purchase or other moneys received by them from the company or shares purchased out of this money presents stand on different footing and may be followed and recovered by the company (*Disdéri & Co.*, (1871) 11 *Eq.* 242; *London and Provincial Starch Co.*, (1869) 20 *L. T.* 390; *MacLean's Case,* (1886) 55 *L. J. Ch.* 36). As to the position of a director entering into contract with his company, the matter has been fully dealt with later. The directors are also trustees of powers for making calls and cannot postpone same to enable one of their number to transfer shares (*Gilbert's Case, Re. National Provincial Marine Insurance Co.*, (1870) 5 *Ch.* 559) or give their own shares a preference as to calls (*Alexander* v. *Automatic Telephone Co.*, (1900) 2 *Ch.* 56). They are also trustees of powers to sanction transfers (*Bennett's Case,* (1854) 5 *De. G. M. & G.* 284). They cannot issue new shares to create a majority in the company or expedite a meeting to prevent new shareholders from having votes (*Piercy* v. *S. Mills Co.*, (1920) 1 *Ch.* 77; *Punt* v. *Symons & Co.*, (1900) 2 *Ch.* 536; *Cannon* v. *Trask,* (1875) 20 *Eq.* 669). The principles here laid down are important inasmuch as they illustrate the difference or distinction between the position of trustee under the ordinary law of trust, and that of the director of a company as to this liability or responsibility with regard to the company's fund with which he is dealing. Here, His Lordships, in course of his judgment said that "to my mind the distinction between the director and trustee is an essential distinction founded on the special nature of things. A trustee is a man who is the owner of the property and deals with it as principal, as owner and as master, subject only to an equitable application to account to some persons to whom he stands in the relation of trustee, and who are his *cestuis que trust*. The same individual may fill the office of director, and also be a trustee having property, but

that is a rare, exceptional, and casual circumstance. The office of a director is that of a paid servant of the company. The director never enters into a contract for himself, but he enters into contracts for his principal, *i.e.*, for the company of whom he is a director and for whom he is acting. He cannot sue on such contracts nor be sued on them unless he exceeds his authority." The position in short as occupied by directors is a fiduciary position, on the same footing more or less as that between a principal and agent (*Jacobus Marler Estates* v. *Marler*, (1916) 85 *L. J. P. C.* 167). It will thus be seen that the directors are in the position of trustees inasmuch as the company's assets and properties are entrusted to them, and therefore, if they misappropriated the same for their own use, or did some other similar wrong, they would be guilty of a breach of trust. On the other hand, the contracts and agreements they enter into on behalf of the company, while acting as its servants and agents, are entered into in their capacity of agents. Again, it has been held that, the funds of a company are by statute made applicable to the purposes specified and thus they are impressed with a quality of trust.

It should be further noted that a director does not necessarily lose his qualification by mortgaging his shares by a blank transfer (*Cummong* v. *Prescot Y. and C.*, (*Ex.*) 488). A joint holding may also qualify a director (*Grundy* v. *Briggs*, (1910) 1 *Ch.* 444). Even in case where the articles lay down that the director should hold his qualification shares "in his own right" it has been held that holding in the capacity of a trustee will do (*Pulbrook* v. *Richmond Consolidated Mining Co.*, (1878) 9 *Ch. D.* 610). This construction is however of late been restricted as in the case of *Boschoek Proprietary Co.* v. *Fuke*, (1906) 1 *Ch.* 148, where a liquidator holding shares as such was declared as not qualified to be a director. The mere fact that the shares are held by the director as a trustee for another company, does not render him liable to account for that fee to the said

company (*Re. Dover Coalfield Extension Co. Ltd.*, (1908) 1 *Ch.* 65).

The fiduciary position of directors has of course its limitations. It does not, for example, apply to directors as shareholders in their own personal rights. There is nothing to prevent them for example from purchasing shares from a deceased shareholder's executors on their own account, if they do so *bona fide* and refrain from taking a wrong advantage of their position. The directors, it must be remembered, are not trustees for individual shareholders, and may purchase their shares without disclosing pending negotiations for the sale of the company's undertaking (*Percival* v. *Wright,* (1902) 2 *Ch.* 421; *Allen* v. *Hyatt,* (1914) 30 *T. L. R.* 444). Where a company appointed a director to represent the interest of a person taking shares and the said person makes a private agreement with the director agreeing to pay for the directors services it was held that the said agreement enforcible because the resolution was taken to have impliedly authorised same (*Kregor* v. *Hollins*, (1913) 109 *L. T.* 225).

Directors as Agents

As agents of the company the directors manage and direct the business of the company according to the powers given to them by the memorandum and the articles of association of the company. In connection with the position of directors as agents it may be stated that though on general principles the knowledge of the directors is not necessarily the knowledge of the company as is the case in case of ordinary law of agency between the principal and agent, still if it is the duty of the director to disclose his knowledge to the company, then that knowledge may be attributed to the company (*Matheram Steam Tramway Co.* v. *Lang,* (1931) 33 *Bom. L. R.* 184). Thus where two companies have directors in common the one of these two companies will not be taken to have notice of the acts of the other (*Hampshire*

Land Co., (1896) 2 *Ch.* 743; *Young* v. *David Payne & Co.*, (1904) 2 *Ch.* 608; *Marseilles Extension Ry. Co.*, (1872) 7 *Ch.* 161). This rule also applies to a secretary of two or more companies (*Fenwick, Stobarat & Co.*, (1902) 1 *Ch.* 507). It may be added that it has also been held that in case it is established by evidence that the duty of investigating and ascertaining facts is delegated to a subordinate official in ordinary course of the company's business, the company will be bound by his knowledge in the same way as it is affected by the knowledge of board of directors (*Evans* v. *Employers Mutual Insurance Association Ltd.*, (1936) 1 *K. B.* 505). Their responsibility to the company in their capacity as agents is synonymous with that of an agent to his principal. As long as they act within their powers, and sign contracts clearly on behalf of the company, they will not be responsible as long as they act honestly, and using their discretion in what they honestly believe to be in the interests of the company. They will therefore not be liable for a simple error of judgment, as opposed to gross negligence. While signing on behalf of the company they must make the fact clear that they are simply acting as agents. According to Palmer (Company Law 12th Edn.): "(1) Where the directors make a contract in the name of or purporting to bind the company, it is the company as the principal which is liable on it, not the directors; they are not personally liable unless it appears that they undertook personal liability (*Lindus* v. *Melrose*, (1858) 3 *H. & N.* 177; *McCollin* v. *Gilpin*, (1880) 5 *Q. B. D.* 390) *e.g.*, by contracting in their own name, or by contracting for the company without using the word 'limited' as part of the name. (2) When directors contract in their own names, but really on behalf of the company, the other party to the contract can, generally, on discerning that the company is the real principal, sue the company on the contract. (3) Where the directors enter into a contract which is within the power of the company but is

beyond the powers of the directors, the company, like any other principal, can ratify the contract (*Grant* v. *United Kingdom Switchback Railway Co.*, (1888) 40 *Ch. D.* 135)." From this it will be seen that the ordinary principles of the law of agency apply to the case of directors when they contract on behalf of the company. In the words of *Lord Cairn* (*Ferguson* v. *Wilson*, (1866) *L. R.* 2 *Ch. App.* 77) "Whenever an agent is liable the directors would be liable. Where the liability would attach to the principal and the principal only, the liability is the liability of the company." We have already dealt with this point as to the form in which the secretary or manager should sign. In one case where the document began with the words, "We, the directors of A. B. C. Limited, hereby agree," it was held that the directors were personally liable. This was so because here directors signed in a form which made the signature their personal signature and the contract a personal contract leaving the creditor option to sue either the company or the directors personally. With regard to the actual contracts entered into either by directors, or any other agents or managers of the company, it may be added that Sec. 88 of our Act lays down that, in case the contract made on behalf of the company is of such a nature, that according to the ordinary law of contracts it must be in writing, then it shall be also in writing, whereas in case of an agreement which if made between private individuals is valid when made by parol only, the same may be made by the company or its agents on its behalf orally. Of course, all contracts entered into on behalf of the company ought to be such as the company is by its constitution empowered to enter into. The directors and other agents of the company may, if so empowered, also draw, accept or endorse, a bill of exchange, hundi, or promissory note on behalf of the company (Sec. 89). In this connection it may be added that, besides the powers given to directors and agents under the articles and the memo-

randum, the company may under its own seal empower any person either generally or in respect of any specified matters, as its attorney to execute deeds on its behalf in any place *either in or outside British India* and every deed signed by such attorney on behalf of the company and under his seal shall bind the company (Sec. 90).

With reference to the power of delegation to directors in one recent case, *viz.*, in the matter of *Union Indian Sugar Mills Co. Ltd.*, (1933) 55 *All.* 810, it has been held that where the managing director of a company had peculiar and extensive powers given to him by the articles of association so that he had the powers of the whole board of directors delegated to him, his knowledge of transaction of pledge of shares was equivalent to the knowledge of the company. It was further decided here that this managing director was here in the position of agent of the company and that under the ordinary law of principal and agent, notice to an agent was notice to the principal. Thus when this managing director pledged his shares with his creditors by handing over the share certificates together with the blank transfer and the creditor neither notified the transaction to the company officially, nor got himself registered as a shareholder, the company had notice of the transaction under the circumstances.

In another case where an agreement was made between the managing director and the company to the effect that "the managing director shall not, at any time while he shall hold the office of a managing director or afterwards solicit, interfere with or endeavour to entice away from the company any persons, firm or company, who at any time during or at the date of determination of the employment of the managing director were customers of or in the habit of dealing with the company," and thereafter when the employment was determined the said managing director opened a business of spare parts of motors, which was one of the branches in which the original company where he was employed dealt with, it

was held by the Court of Appeal reversing the decision of Farewell, J. that in the circumstances the covenant as given above was not wider than was reasonably necessary for the protection of the employer company's trade and was therefore enforceable by injunction (*Gilford Motor Co., Ltd.* v. *Horne,* (1933) *Ch. D.* 935).

In one other case where the articles of a company provided that the governing directors had power to appoint and to remove additional directors, it was held that this power can be exercised only by all the governing directors and not by a majority of them (*Parrott & Parrott Ltd.* v. *Stephensons,* (1933) *W. N.* 522). Where articles gave power to directors to appoint managing director, a company in general meeting cannot interfere even though one other article empowered the directors to manage only subject to such regulations as the company might prescribe (*Thomas Logan* v. *Davis,* (1911) 104 *L. T.* 914; 105 *L. T.* 419).

In a recent English case articles gave powers to the directors to delegate to one or more directors such of the powers conferred on them as they may consider requisite for carrying on of the business and to determine who should be entitled to sign contracts and documents on behalf of the company. A document which was a guarantee was signed by a director for the company and it was declared by the Court that the party to whom this guarantee was given was entitled to presume that the board of directors authorised this particular director to sign the contracts on behalf of the company and that therefore the company was liable (*British Thomson Houston Co., Ltd.* v. *Federated European Bank Ltd.,* (1932) 2 *K. B.* 176).

A Judicial Summary of Directors' Duties

In the well-known case *In Re. City Equitable Fire Insurance Co. Ltd.,* (1925) 1 *Ch. D.* 407, quite recently decided, *Romer, J.* summarised the duties of the directors. His Lordship laid down that "(1) the manner in which

the work of a company is to be distributed between the board of directors, and the staff is a business matter to be decided on business lines. (2) In discharging his duties a director must act honestly and must exercise such degree of skill and diligence as would amount to the reasonable care which an ordinary man might be expected to take in the circumstances on his own behalf. But he need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his skill and experience. (3) He is not liable for mere errors of judgment. (4) His duties are of an intermittent nature to be performed at periodical board meetings and he is not bound to give continuous attention. (5) Though not bound to attend all such meetings he ought to attend them when reasonably able to do so. (6) In regard to all such duties which may properly be left to some other official, he is, in absence of grounds for suspicion, justified in trusting that official. (7) It is the duty of each director to see that the company's moneys are from time to time in a proper state of investment, except so far as the articles of association justify him in delegating that duty to others. (8) The director in recommending a dividend and presenting the annual report and the balance sheet, should not merely be guided by the assurance of their chairman, however apparently distinguished and honourable, nor with the expression of belief of their auditors but should himself have a detailed list of the company's assets and liabilities prepared for his own use. (9) It is the duty of the director of a big insurance company to personally supervise the safe custody of the company's securities."

In one case where the directors were charged with negligence inasmuch as they were accused of having allowed a decree to be time-barred which they ought to have taken steps to recover, it was held that onus was on the company to establish (1) that the decretal amount could have been received from the judgment-debtors and (2) that the failure to do this was due to the negligence

of the directors (*Guntur Cotton Jute & Paper Mills Ltd. v. Pydah Venkatachalapati*, (1933) 35 *Bom. L. R.* 407).

Indemnity Clause to Protect Directors, Etc.

Formerly it was usual to insert a clause in the articles of association by which the directors and all the officers as well as the auditors were relieved from all responsibility and liability in case they were guilty of misfeasance or negligence however gross except of course in case of fraud. This Indemnity Clause was declared to be a valid and binding clause in the famous *City Equitable Case* we have cited above. However on recommendation of Greene Commission the English Act of 1929 declared the said clause to be void. Our Act has followed suit and now it has laid down that "*save as provided in Sec. 86C any provision, whether contained in the articles of a company or in any contract with a company or otherwise, for exempting any director, manager or officer of the company or any person (whether an officer of the company or not) employed by the company as auditor from or indemnifying him against any liability which by virtue of any rule of law would otherwise attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company shall be void*:"

The only exceptions provided for are in cases:

(1) *where in relation to the Indemnity Clause which was in force at the date of the commencement of the Indian Companies (Amendment) Act, 1936, this section is to have effect only on the expiration of a period of six months from that date,*

(2) *it shall not operate to deprive any person of any exemption or right to be indemnified in respect of anything done or omitted to be done by him while any such provision was in force* and

(3) *notwithstanding anything in this section, a company may, in pursuance of any such provision as aforesaid indemnify any such director, manager, officer or auditor against any liability incurred by him in defending any*

proceedings, whether civil or criminal, in which judgment is given in his favour or in which he is acquitted, or in connection with any application under Section 281 of this Act in which relief is granted to him by the Court.

Loans to Directors

The practice of taking loans from companies of which they were directors became a scandal in this country with the result that the Bombay Shareholders' Association and other public bodies protested against same. As a result, Sec. 86D (1) was introduced into our Act by the Indian Companies (Amendment) Act of 1936 which expressly forbids loans of any kind to a director other than the director of a banking company or that of a private company. It is thus laid down expressly that *no company shall make any loan or guarantee any loan made to a company or to a firm of which such director is a partner or to a private company of which such partner is a director.*

In addition, Sec. 86D (2) lays down that *if the provision of the above sub-section is contravened, any director who is a party to such contravention shall be punishable with fine which may extend to rupees five hundred and if default is made in repayment of the loan or in discharging the guarantee he shall be liable jointly and severally for the amount unpaid.*

Office of Profit held by Directors

It is now laid down by Sec. 86E that *no director or firm of which such director is a partner or private company of which such director is a director shall, without the consent of the company in general meeting, hold any office of profit under the company except that of a managing director or manager or a legal or technical adviser or a banker. The only exception is that nothing herein contained shall apply to a director appointed before the commencement of the Indian Companies (Amendment) Act of 1936 in respect of any office for profit under the company held by him before the commencement of this Act.*

For the purpose of this section, however, the office of managing agent is not to be deemed to be an office for profit under the company.

Restriction on Powers of Sale and Remission of Debts by Directors

The new Indian Companies (Amendment) Act of 1936 now lays down that *directors of a public company or of a subsidiary company of a public company shall not, except with the consent of the company concerned in general meeting, sell or dispose of the undertaking of the company or remit any debt due by a director* (*Sec. 86H*).

This was done because a constant practice of disposing of the undertaking of the company was noticed among Indian companies in which the shareholders were never consulted and large amounts of debts due by directors were remitted by the board without consulting the company in general meeting.

CHAPTER XI

The Directors *(Continued)*

Liability of Directors

We have seen that the directors enter into contracts on behalf of the company and with respect to these contracts, they are not personally liable as long as they do not exceed their authority, or do anything which is grossly negligent. Of course, if they give a personal guarantee with respect to any of the agreement, they would be liable on such a guarantee. With regard to their exceeding authority it may be mentioned that if the directors apply the money of the company for a purpose other than that for which the company is incorporated, they would be personally liable to make good such money. We have already seen that a mere error of judgment will never make the directors personally liable, but something more, *i.e.*, gross negligence or dishonest intention will have to be proved (*In Re. Lagunas Nitrate Company* v. *Lagunas Syndicate*, (1899) 2 *Ch. D.* 392). Here *Lindley, M. R.*, says, "As director, I am not aware that there is any difference between their legal and their equitable duties. If directors act within their powers, if they act with such care as is reasonably to be expected from them, having regard to their knowledge and experience, and if they act honestly for the benefit of the company they represent, they discharge both their equitable as well as their legal duty to the company. In this case they clearly acted within their powers. They did nothing *ultra vires*, fraud is not imputed. The enquiry, therefore, is reduced to want of care and *bona fides* with a view to the interests of the Nitrate Company. The amount of care to be taken is difficult to define; but it is plain that directors are not liable for all the mistakes they may make, although, if

they had taken more care, they might have avoided them (See *Overend Gurney & Co.* v. *Gibb,* (1872) *L. R.* 5 *H. L.* 480). Their negligence must not be the omission to take all possible care; it must be much more blameable than that; it must be, in a business sense, culpable or gross. I do not know how better to describe it." This principle was confirmed *In Re. National Bank of Wales, Ltd.,* (1899) 2 *Ch. D.* 629. A summary of duties and liabilities of the directors as laid down by *Romer, J.* in the recent case *In Re. City Equitable Fire Insurance Co. Ltd.,* (1925) 1 *Ch. D.* 407 has already been dealt with. Generally speaking, what is expected of a director is the exercise of as much reasonable care in the conduct of the business of the company as a prudent business man would do in case the business was his own. A director who is entrusted with any money by the company is bound to make good same in case he has not dealt with the money according to the provisions of the memorandum and the articles as he was asked to do. Although he may not have derived any benefit therefrom and there was no corrupt motive (*Ex parte Pelly,* (1882) 21 *Ch. D.* 492 see. p. 509). See also *In re. Sharpe,* (1892) 1 *Ch.* at pages 165 and 166 where *Lindley L. J.* has laid down that " as soon as the conclusion is arrived at that the company's money has been applied by the directors for purposes which the company cannot sanction, it follows that the directors are liable to replace the money, however honestly they may have acted." But where the directors has been acting within his powers as the agent of the company, and while so acting incurs some liability, he is entitled to be indemnified by the company for same, *e.g.,* as in one case *Famatina Development Corporation,* (1914) 2 *Ch. D.* 271, where a director defended a libel action successfully in connection with a statement made in the report, he was held to be entitled to his costs. The director who has not been attending board meetings will not be liable on the charge of negligence for that reason only (*Marquis of Bute's Case,* (1892) 2 *Ch. D.* 100). Where directors who are indebted

to a company sign a balance sheet in performance of their duties as directors, the balance sheet is not an account stated involving a fresh promise by the directors to pay the amounts debited to them therein if it were not signed by them with the intention of making such a promise (*John Shaw & Sons, Ltd.* v. *Peter Shaw & John Shaw*, (1935) 2 *K. B.* 133). In case a director signs bills of exchange not bearing the company's name he would be personally liable. Directors who sanction payment on behalf of the company, ought to see that the said payments are properly made, *i. e.*, they are made for the purposes which come within the scope of the company's operation. The directors who join in any misapplication of money are jointly and severally liable but those who are, however, not responsible for misconduct (See *Ex parte Pelly* quoted above) of their co-directors, or of other persons employed in the company, in case they were not aware of same (*Weir* v. *Burnett*, (1877) 3 *Ex. D* 32; *Weir* v. *Bell*, (1878) 3 *Ex. D.* 238).

One of the most important duties of the directors is to see that a general meeting of the company, public or private, is held *within eighteen months from the date of its incorporation and thereafter* once at least in every calendar year and not more than fifteen months after the holding of the last preceding general meeting (S. 76). In case of a public company it is also their duty *after the balance sheet and profit and loss account have been laid before the company at the general meeting to file a copy of the balance sheet signed by the manager or secretary of the company with the registrar at the same time as the copy of the annual list of members and summary prepared in accordance with Sec.* 32 (*Sec.* 134). Failure to do either entails a fine. If a director is prosecuted for not filing this balance sheet with the registrar as required by Sec. 134 (4) of the act, he cannot plead, in answer, that an annual general meeting was not called and therefore a balance sheet was not laid before the meeting (*Debendranath Das Gupta* v. *Registrar of Joint Stock Companies*, (1918) 45 *Cal.*

486; See also *Emp.* v. *Nasurbhai,* (1923) 25 *Bom. L. R.* 224).

Unlimited Liability of Directors

We have already seen that, in accordance with Sec. 70, the liability of directors of a limited company may, if so provided by its memorandum, be unlimited. In this case the member who proposes a person for election, or appointment to the office of director, shall add to that proposal a statement that the liability of the person holding that office will be unlimited and the promoters and officers of the company, or one of them shall, before the person accepts the office or acts therein, give him notice in writing that his liability will be unlimited. A limited company can, even after its incorporation according to Sec. 71, if authorised by its articles, alter its memorandum by a special resolution so as to render unlimited the liability of its directors or of any director. In such a case such a director or directors in addition to his or their liability, if any, to contribute as ordinary member or members, will be liable to make contribution on the same basis as if he were a member of an unlimited company in liquidation. This will, of course, not apply to a past director who ceases to hold office for a year or upward, before the commencement of the winding up, nor will it apply in case where the liability in respect of which the said contribution is levied was incurred after the directors ceased to hold office. Here also subject to the articles, a director shall not be liable to make such further contribution unless the Court deems the said contribution necessary in order to satisfy the debts and liabilities of the company, plus the costs, charges and expenses of the winding up (S. 157).

For Company's Benefit

In *Piercy* v. *S. Mills & Co. Ltd.*, (1920) 1 *Ch. D.* 77 it was held that, the power vested in the directors of a joint stock company to issue more shares, in order to raise

more capital, must be exercised *bona fide* for the benefit of the company. They are not entitled to use their powers of issuing shares merely for the purpose of maintaining their control, or the control of themselves and their friends over the affairs of the company, or merely for the purpose of defeating the wishes of the existing majority of shareholders.

The fiduciary position of the directors forces on them the duty of abstaining from making any secret profit or using that position to benefit themselves in any other way such as by bribes, allotting themselves fully paid shares (*Madrid Bank* v. *Relly,* (1867) 7 *Eq.* 442; *Parker* v. *McKenna,* (1875) 10 *Ch.* 96). We shall deal with the fiduciary position more fully later in this chapter.

Liability Through Contract

Besides this, the directors may make themselves liable on contracts which they make on behalf of the company, by exceeding their authority, and in such case they make themselves personally liable to action or damages for breach of warranty of authority (*Collen* v. *Wright*. (1857) 8 *E. & B.* 647; *Coventry's Case, Britannia Fire Association,* (1891) 1 *Ch.* 202). Here their position is that of agents as we have seen before and therefore if the liability is saddled on them, it will be on the footing that, as agents, they do not contract within their position as agents. This will happen where the contract is in their own personal names without disclosing that they were acting as agents of the company, if for example, they sign themselves as :—

X., Y., Z.,
Directors of,
The Bombay Trading Co.

they would be personally liable because here they did not, on the face of the document, sign on behalf of the company but for themselves. Even where they begin the document as "We the directors of the Bombay Trading Co., Ltd.

hereby agree" and then sign as :—X., Y., Z., they would be personally liable (*Aggs* v. *Nicholson,* (1856) 1 H. *& N. Ex. Rep.* 165; *McCollin* v. *Gilpin,* (1880) 5 *Q. B. D.* 390). The directors have to take particular care here while signing bills of exchange, as otherwise they may be saddled with personal liability as has happened in numerous cases. Secs. 73 and 74 deal particularly with the cases of bills of exchange, hundis, promissory notes, endorsements, cheques and orders for money or goods purported to be signed by or on behalf of the company. In this connection it is laid down that the name of the company with the word "limited" should be mentioned specifically while the directors sign on behalf of the company and in case of bills of exchange, hundi, promissory note, cheque, or order for money or goods this is not done, *i.e.*, the name of the company is not mentioned in the manner required by these sections, the directors and officers concerned will not only be liable to a fine not exceeding Rs. 500 but they shall further be personally liable to the holder of such documents for the amount thereof unless the same is duly paid by the company.

In connection with contracts the other point is that as long as the contracts which the directors are entering into are *intra vires, i.e.*, within their scope, the third party has a right to insist upon the company to keep same. Thus where the servants of a company order goods and the company takes delivery of them without protest, they cannot afterwards repudiate the purchase (*Smith* v. *Hull Gas Co.,* (1852) 11 *C. B.* 897). If on the other hand the directors have exceeded their authority, the contract will not bind the third parties unless the company ratifies same (*Portuguese Consolidated Copper Mines, Badman's and Bosanquet's Cases,* (1890) 45 *Ch. D.* 16; *Austin's Case,* (1871) 24 *L. T.* 932; *Ford* v. *Newth, in re. Gloucester Municipal Election Petition,* (1901) 1 *K. B.* 683). The directors, of course while contracting can pledge the credit of the company as such and not that of the members and thus in one case where in

a foreign country the company was carrying on business the law made the members liable, it was held that that law did not apply to the British Courts (*Risdon Iron & Locomotive Works* v. *Furness*, (1906) 1 *K. B.* 49). In cases where the directors act beyond their powers and are fixed with personal liability, it has been held that the persons dealing with the company will not, as against the directors, be fixed with implied notice of the contents of the articles (*Collen* v. *Wright*, (1857) 8 *E. & B.* 647). Of course where the third party knows that the directors have no authority or does not rely upon the question of the authority at all but on other facts, or where the nature of the directors' authority is fully known to him, but he misunderstands the legal effect of same the directors cannot be made liable personally (*Oliver* v. *Bank of England*, (1902) 1 *Ch.* 610 *at p.* 630; *Beattie* v. *Lord Ebury*, (1872) 7 *Ch.* 777; *Young* v. *Toynbee*, (1910) 1 *K. B.* 215).

Where directors act beyond authority relying on statements and advise given to them and have not been guilty of gross negligence they will not be liable (*Dovey* v. *Cory*, (1901) *A. C.* 477; *Prefontaine* v. *Grenier*, (1907) *A. C.* 101). If however they act beyond their authority with full knowledge of the relevant facts they are liable (*National Funds Assurance Co.*, (1878) 10 *Ch. D.* 118). They would be equally liable if they relied on their subordinates and did not make inquiry themselves which would have given their full knowledge (*Leeds Estates Building and Investment Co.* v. *Shepherd*, (1887) 36 *Ch. D.* 787; *Municipal Freehold Land Co.* v. *Pollington*, (1890) 63 *L. T.* 238).

From the above it should not be thought that where directors voluntarily undertake the liability personally in connection with any particular work, they cannot do so. However when a contract is entered into and the directors intend to make themselves personally liable, though the contract is on behalf of and for the benefit of the company, the construction and the wording of the contract must be clear on that point. Where however they enter into contracts in their own name without making it clear

that they are acting as agents of the company, they will also be saddled with personal liability. Where it is not clear from the text as to whether they intended to be personally liable, the Court would have to construe the exact meaning and effect of the terms of the contract. Directors can accept, endorse and draw bills of exchange on behalf of their company if so authorised expressly or impliedly by the company's constitution. In case of a trading company we have seen that the power to borrow is limited and thus the bill of exchange, promissory notes and similar documents may be made use of by the company. In case of non-trading companies this power not being implied, the memorandum of association must contain an express power to that effect. Thus in case of a Gas Company in absence of an express power, the power to draw or accept bills of exchange was declared not to be implied (*Bramah* v. *Roberts,* (1837) 3 *Bing. N. C.* 963). The same was the case with a Mining Co., (*Dickinson* v. *Valpy,* (1829) 10 *B. & C.* 128), also a Railway Co., *Bateman* v. *Mid-Wales Rail Co.,* (1866) *L. R.* 1 *C. P.* 499. While signing on behalf of the company, the precautions above referred to and the illustrations given should be borne in mind. The Indian Companies Act, Sec. 89 in this connection is rather important, which runs as follows :—

"A bill of exchange, hundi or promissory note shall be deemed to have been made, drawn, accepted or endorsed on behalf of a company if made, drawn, accepted or endorsed in the name of, or by or on behalf or on account of, the company by any person acting under its authority, express or implied."

Of course besides the directors, the managing agents or other persons authorised by the articles may deal with bills of exchange and similar documents by endorsing, accepting or drawing same. Where a company is not liable on a negotiable instrument on the ground that it is irregularly drawn or accepted, it may be held so liable on other grounds such as the original debt on account of which the same was given or for money received by the

company to the use of the holder (*Re. Nursery Spinning & Weaving Co. Ltd.*, (1881) 6 *Bom.* 92).

If a person were to lend money to a company which loan afterwards turned out to be *ultra vires,* he would be entitled to be subrogated to the rights of the creditors of the company who were paid out their claims out of the money so borrowed and in case he intervenes in time, *i.e.*, before the money has been dealt with by the company in any way, he may get back the money itself by restraining the company from parting with it (*Wenlock* (*Barroness*) v. *River Dee Co.* (No. 2), (1887) 19 *Q. B. D.* 155; *Sinclair* v. *Brougham,* (1914) *A. C.* 398). In one case where the directors while signing these documents described the company under a wrong name they were held to be personally liable (*Nassau Steam Press* v. *Tyler,* (1894) 70 *L. T.* 376). The word 'limited' should always be there in connection with the name of the company if it is a limited company. In one case, directors were held not to be personally liable because they proved that the word limited over-lapped the paper and did not appear because the rubber stamp was rather lengthy (*Dermatine Co.* v. *Ashworth,* (1905) 21 *T. L. R.* 510). In another case where a managing director signed a bill on behalf of the company without having specific authority to do so, the company was held responsible to a holder in due course for value (*Dey* v. *Pullinger Engineering Co.,* (1921) *I. K. B.* 77).

Directors' Contracts with the Company

We have thus seen one aspect of the contracts by directors *viz.,* directors' power to enter into contracts *on behalf* of the company. The next point to consider is the position of the directors to contract *with* the company on their behalf or in their (directors') own interests. Here the position is that directors cannot enter into contracts with their company unless the articles of association otherwise provide (*Albion Steel and Wire Co. v. Martin,* (1875) 1 *Ch. D.* 580). In practice almost all

companies now provide for this power in their articles. The reason is that here they are in a fiduciary position and their interests are in conflict with their duties. Thus in the absence of such a provision as above stated in the articles even though the contract may be quite above board it will not make any difference in law as the company is entitled to have the benefit of the collective wisdom of its directors (*Imperial Mercantile Credit Association* v. *Coleman,* (1871) 6 *Ch.* 558; *Ramaswamy Aiyar* v. *Madras T. P. & P. Co.,* (1915) 38 *Mad.* 991), but as this case shows the company can waive the benefit of this rule. The Indian Companies (Amendment) Act, 1936 further lays down that *in case of certain specific contracts by a director with the company such as those for sale purchase or supply of goods and materials consent of directors has to be obtained* (Sec. 86F). It is also laid down further that *the directors of a public company or of a subsidiary company of a public company shall not except with the consent of the company concerned in general meeting* (*a*) *sell or dispose of the undertaking of the company or* (*b*) *remit any debt due by a director.* Directors who have wrongfully taken benefit of a contract with their company, must indemnify the company (*Eastern Shipping Co.* v. *Quah Beng Kee,* (1924) *A. C.* 177). A company may, however, in the absence of such an article, sanction a contract with a director in a general meeting (*Grant* v. *United Kingdom Switchback Ry. Co.,* (1889) 40 *Ch. D.* 138), but here care should be taken to see that notice convening the meeting to consider such a contract gives particulars as to such a contract (*Kaye* v. *Croydon Tramways Co.,* (1898) 1 *Ch.* 358; *Normandy* v. *Ind, Coope and Co.,* (1908) 1 *Ch.* 84). The disclosure of interest to brother directors must be full and fair and that too to independent directors who are not interested. This rule cannot be evaded by splitting the resolution or reducing the quorum (*Turnbull* v. *West Riding Club,* (1894) 70 *L. T.* 92; *Gluckstein* v. *Barnes,* (1900) *A. C.* 240; *Greymouth P. E. Ry. Co.,* (1904) 1 *Ch.* 32; *Re.*

Sir Hormusji A. Wadia, (1921) 23 *Bom. L. R.* 1104; *Re. North Eastern Insurance Co.,* (1919) 1 *Ch.* 198). When directors obtain a contract in their own name but under circumstances amounting to a breach of trust they will be liable to account to the company (*Cook* v. *Deeks,* (1916) 1 *A. C.* 554). Even an article which permits the directors to contract with the company "without disclosing their interest", would be bad. (Ss. 91 A and 91 B). A power to contract with firms with which directors are interested does not authorise a contract by them individually with the company (*Transvaal Lands Co.* v. *New Belgium Land and Development Co.,* (1914) 2 *Ch.* 488). Where vendors who have become directors and have covenanted to serve for a given number of years and not to compete with the company during these years, they are discharged from this obligation in case their services are dispensed with directly and through the company going into winding up. The result is that they are free to enter into competing business (*General Bill Posting Co.* v. *Atkinson,* (1909) *A. C.* 118; *Measures Bros.* v. *Measures,* (1910) 2 *Ch.* 248). A director is interested in the issue of debentures which are so issued to secure a debt which he has guaranteed (*Victors* v. *Lingard,* (1927) 1 *Ch.* 323). A director interested in a contract with the company though prevented from voting at the board meeting, can vote at a shareholders' general meeting (*North West Transportation Co.* v. *Beatty,* (1887) 12 *A. C.* 589). In one case however it has been held that the directors cannot use their voting power as shareholders, to deprive a company of property which belongs to the company in equity (*Cook* v. *Deeks,* (1916) 1 *A. C.* 554).

It should thus be noted that where this power is not expressly given by the articles the directors' powers to contract with their companies become very limited. However he may take up shares in the company, though he cannot vote for them at the time of allotment (*Neal* v. *Quin,* (1916) *W. N.* 223). He can also subscribe for debentures in the ordinary course of business

(*Campbell's Case*, (1877) 4 *Ch. D.* 470). This rule of law which prevents the directors from contracting with the company in absence of special powers in the articles is based, as we have seen, upon the principle laid down in old cases to the effect that the company was entitled to the collective wisdom of its directors, and thus, if any of them are interested in a contract which the company is going to make, the company would be losing the benefit of the unbiased judgment and advice of the directors (*Imperial Mercantile Credit Association* v. *Coleman*, (1871) 6 *Ch. App.* 558; *Costa Rica Rail Co.* v. *Forwood*, (1900) 1 *Ch.* 756 *affirmed*, (1901) 1 *Ch.* 746). This rule is very strictly applied in absence of powers and no question is allowed to be raised as to the fairness or unfairness of the contract (*Bray* v. *Ford*, (1896) *A. C.* 44 *at page* 50; *Aberdeen Rail Co.* v. *Blaikie Bros.*, (1854) 1 *Macq.* (*H. L.*) 461). It will also not help the director concerned to sell his own property to the company through a third party without disclosing the fact, because in such cases the company would be entitled to reject the contract and recover money paid if any (*In re. Cape Breton Co.*, (1885) 29 *Ch. D.* 795). The company here will have option to claim damages or losses sustained by this concealment and retain the property (*Leeds & Hanley Theatres of Variety Co.*, (1904) 2 *Ch.* 45). The question of interest does not only extend to the director being interested personally or as a partner of a firm which is contracting with the company, but even if a director is holding shares in any other company which company is contracting with the company of which he is a director, the same rule would apply in absence of an article conferring the power on the director to contract with the company (*Transvaal Lands Co.* v. *New Belgium Co.*, (1914) 2 *Ch.* 488). We have already mentioned above that in absence of the articles giving such power, a resolution of a general meeting properly convened may confirm such a contract (*Grant* v. *United Kingdom Switchback Ry. Co.*, (1888) 40 *Ch. D.* 138; *Kaye* v. *Croydon Tramways Co.*, (1898) 1 *Ch.*

358: *Costa Rica Rail Co.* v. *Forwood,* (1901) 1 *Ch.* 746). In one case it was held that where the directors had guaranteed an overdraft to the company they were interested in the issue of debentures with a view to secure the overdraft (*Victors* v. *Lingard,* (1927) 1 *Ch.* 323).

Forms or Precedents of Articles Empowering the Directors to Enter into Contracts with the Company

As we saw above the directors cannot enter into contracts with the company unless empowered to do so by the articles or unless the company in general meeting permits them to do so. An ordinary resolution for such a permission would be necessary. It is, however, universal in case of Indian companies to insert clauses in the articles empowering the directors to enter into such contracts. The following is a model clause :—

No director shall be disqualified by his office from contracting with the company *with the consent of the board of directors for the time being* either as vendor, purchaser, or otherwise, nor shall any such contract, or any contract or arrangement entered into by or on behalf of the company in which any director shall be in any way interested, be avoided, nor shall any director so contracting or being so interested be liable to account to the company for any profit realised by any such contract or arrangement by reason of such director holding that office or the fiduciary relation thereby established, but it is declared that the nature of his interest must be disclosed by him at the meeting of the directors at which the contract or arrangement is determined on, if his interest then exists, or in any other case, at the first meeting of the acquisition of his interest, and that no director shall, as a director, vote in respect of any contract or arrangement in which he is so interested as aforesaid, and if he does so vote, his vote shall not be counted; but this prohibition shall not apply to any contract by or on behalf of the company to give to the director or any of them any security for advances or by way of indemnity, or to a settlement or set-off of cross claims. A general notice that a director is a member of any specified firm or company, and is to be regarded as interested in any subsequent transactions with such firm or company, shall be sufficient disclosure under this clause, and after such general notice it shall not be necessary to give any special notice relating to any particular transaction with such firm or company.

NOTE :—*Now under Sec. 86F it is provided that a director of a company or the firm of which he is a partner or a private company of which he is a member or director cannot without the consent of the directors enter into contracts for sale, purchase or supply of materials with the company.*

The other alternative clause is as follows :—

No director shall be disqualified by reason of his office from contracting with the company *with the consent of the board of directors for the time being* either as vendor, purchaser or otherwise, nor shall any such contract, or any contract or arrangement entered into by or on behalf of the company in which any directors shall be in any way interested, be avoided nor shall any director so contracting or being so interested be liable to account to the company for any profit realised by any such contract or arrangement by reason of such director holding that office or the fiduciary relation thereby established but it is declared that the nature of his interest must be disclosed by him at the meeting of the directors at which the contract or arrangement is determined on if his interest then exists, or in any other case at the first meeting of the directors after the acquisition of his interest *provided however* that a general notice that a director is a member of any specified firm or company, and is to be regarded as interested in any subsequent transactions with such firm or company, shall be sufficient disclosure under this clause, and after such general notice it shall not be necessary to give any special notice relating to any particular transaction with such firm or company. No director shall, as a director, vote in respect of any contract or arrangement in which he is so interested as aforesaid and if he does so vote his vote shall not be counted; but this prohibition shall not apply to any contract by or on behalf of the company to give to the directors or any of them any security for advance or by way of indemnity or to a settlement or to set-off cross claims.

A third alternative clause is as follows :—

No director shall be disqualified by his office from holding any office or place of profit under the company, or under any company, partnership, association, or corporation in which this company shall be shareholder or otherwise interested or from contracting with the company either as vendor, purchaser or otherwise (*provided he does so with the consent of the board of directors for the time being*) nor shall any such contract or any contract or arrangement entered into by or on behalf of the company in which any director be liable shall be in any way interested be avoided nor shall any director to account to the company for any profit

arising from any such office or place of profit or realised by any such contract or arrangement by reason of such director holding that office or the fiduciary relation thereby established, but it is declared that the nature of his interest must be disclosed by him at the meeting of the directors at which the contract or arrangement is determined on if his interest then exists, or in any other case at the first meeting of the directors after the acquisition of his interest.

Liability as to Fraud or Tort

In this connection we have already seen the liability of directors in connection with misrepresentation or fraud in the prospectus. The commission of any tort also would involve personal liability, on the simple principle that any person who commits a wrong is liable personally, even though he may be acting on behalf of a principal, because no agent is bound to obey his principal in connection with tort or fraud or commit it simply because his principal wants him to do so (*Cullen* v. *Thompson's Trustees,* (1862) 4 *Macq.* 424). It will make no difference where the company itself is also liable. As far as the company is concerned, though it is an inanimate body which is practically run through the efforts of its officers and directors, it would be liable to innocent third parties who have been injured through the torts or fraud of its officers, committed in regular course of its business. On the same principle, any principal would be liable for similar tort of his agent in the regular course of the principal's business (*Ranger* v. *Great Western Railway Co.,* (1854) 5 *H. L. Cas.* 72). It is on this principle that companies have been made liable for negligence, trespass, malicious prosecution, libel, and nuisance (*Parnaby* v. *Lancaster Canal Co.,* 11 *Ad. & El.* 223; *Maund* v. *Monmouthshire Canal Co.,* (1842) 4 *Man & Gr.* 452; *Whitfield* v. *South Eastern Ry. Co.,* (1858) *E. B. & E.* 115). Of course, the company cannot be committed for trial (*R.* v. *Daily Mirror Newspapers Limited,* (1922) 2 *K. B.* 530). The directors, through whose orders the above-mentioned acts were committed, may also be personally made liable as wrong doers. In

case of fraud, a director is not held liable for the fraud of his brother director, unless he, directly or indirectly or by implication, is found to have authorised it (*Cargill* v. *Bower*, (1878) 10 *Ch. D.* 502). When the directors conspire with outsiders and commit fraud on the company of which they are directors, the company can recover the money paid by directors to such persons in furtherance of the fraud (*British and American Telegraph Co.* v. *Albian Bank*, (1872) *L. R.* 7 *Ex.* 119). There are cases where the directors may be made criminally liable for the acts of a company which they control (*R.* v. *Cory Bros.*, (1927) 1 *K. B.* 810).

The above liability for tort of the director is personal, besides the company being liable. This is on the ground that a person who commits a tort is liable personally notwithstanding the fact that he may be acting for somebody else. Simply because he was a servant or agent, he is not compelled in law to do anything wrong such as committing fraud. To put it briefly every wrong doer is liable on a tort irrespective of the fact whether he acted for himself or somebody else. However, the director who has himself committed a tort is responsible and one who has not cannot be held responsible for the fraud of his co-directors unless he impliedly or expressly authorised it (*Cargill* v. *Bower*, (1878) 10 *Ch. D.* 502). The other position to be remembered is that instead of committing a fraud himself the director himself may be defrauded by an outsider and for that he could not possibly be made to pay damages for the losses sustained by the company (*Land Credit Co. of Ireland* v. *Lord Fermoy*, (1870) *L. R.* 5 *Ch. App.* 763 *at page* 772; *Profontaine* v. *Grenier*, (1907) *A. C.* 101; *Dovey* v. *Cory*, (1901) *A. C.* 477).

Liability for Negligence

No doubt directors do not bring with them any special qualifications for their office but they are bound, while acting as directors, to act with such care as can

reasonably be expected of them, having regard to the knowledge and experience they happen to possess (*In Re. Brazilian Rubber Plantations,* (1911) 1 *Ch.* 425). In this connection the Indian Companies Act, Sec. 281 as amended by the Indian Companies (Amendment) Act of 1936 gives certain amount of protection to the directors, managers, managing agents, officers and auditors of the company.

It is here laid down that if in any proceeding for negligence, default, breach of duty or breach of trust against directors, managers, managing agents, officers and auditors of a company, it appears to the Court on hearing the case that that person is or may be liable in respect of the negligence, default, breach of duty or breach of trust but he has acted honestly and reasonably and that having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused for the negligence, default, breach of duty or breach of trust, that Court may relieve him, either wholly or partly from his liability on such terms as the Court may think fit. [Sec. 281 (1)].

It is further laid down that *where any person to whom this section applies has reason to apprehend that any claim will or might be made against him in respect of any negligence, default, breach of duty or breach of trust, he may apply to the Court for relief and the Court on any such application shall have the same power to relieve him as under this section it would have had if it had been a Court before which proceedings against that person for negligence, default, breach of duty or breach of trust had been brought* [Sec. 281 (2)].

Of course, this section would apply only where *ultra vire* acts have been done by directors in good faith (*Claridge's Patent Asphalte Co.,* (1921) 1 *Ch.* 543). Thus the directors who have paid dividends out of capital may escape liability if it appears that they acted *bona fide* and in the belief that there were profits available for

payment of same. Here it was held that they would be quite justified, in relying upon the reports and valuation of the trusted officers of the company and are not liable if book debts which they believed to be true turned out to be bad (*Rance's Case,* (1871) 6 *Ch.* 104; *Dovey* v. *Cory,* (1901) *A. C.* 477; *City of Glasgow Bank* v. *Mackinnon,* (1882) 9 *Court of Sess. C. A. Fort Series* 602), but in all these cases they must show that they have exercised their discretion in good faith (*New Mashonaland Syndicate,* (1892) 3 *Ch.* 577). Of course, it is very difficult to lay down how the margin of *bona fide* action and diligence could be fixed but generally speaking, the effect of all the judgments display that, unless the negligence is very gross which would amount to almost a fraud, the directors will not be held liable to damages. We have already seen under the heading of directors as agents that in the famous case, *In Re. City Equitable Fire Insurance Co. Ltd.,* (1925) 1 *Ch. D.* 407, the principles as to directors' liability for negligence, errors of judgment, etc.. are laid down in some detail. There it is laid down that such degree of skill and diligence as would amount to reasonable care which an ordinary man may be expected to take in the circumstances on his own behalf is expected and a person cannot be expected to exhibit greater skill than he happens to possess. Here it was also laid down that though a director was not bound to attend all board meetings he ought to do so when reasonably able. In another case, *viz., Marquis of Bute's Case,* (1892) 2 *Ch.* 100, it was laid down that non-attendance of board's meeting is not such negligence as to create a liability. The negligence or imprudence of a director in some cases may be so palpable or gross as to force the inference that they were not acting *bona fide,* though of course, the expression, 'gross negligence' has been repeatedly challenged as meaningless in Courts of Law on the ground that negligence is negligence and there cannot be any degree attached to that. In one case *Rolfe, B.* declared that " gross negligence is the same thing as negligence

with the addition of *vituperative epithet*" (*Wilson* v. *Brett*, (1843) 11 *M. & W.* 115-116 *at p.* 130). It has been further held that the party who charges the director with not having performed his duty has to prove his case (*In Re. Liverpool Household Stores*, (1890) 59 *L. J. Ch.* 16). In a recent Privy Council case it was laid down that, in order to render directors liable for allowing decrees to become time-barred, the onus is on the company to establish (1) that the decretal amount could have been recovered from the judgment-debtors and (2) that the failure to do this was due to negligence of directors (*Guntur Cotton Jute and Paper Mills Co., Ltd.* v. *Pydah Venkatachalapati*, (1933) 35 *Bom. L. R.* 407). While acting in the capacity of directors they are entitled to trust their co-directors where there is no ground for suspicion and a director would also be entitled to rely upon the judgment, information and advice upon the company's responsible officials (*Dovey* v. *Cory*, (1901) *A. C.* 477). If the directors act within their powers having regard to their knowledge and experience in what they believe to be the company's benefit they would not be liable for mistakes or errors of judgment (*Lagunas Nitrate Co.* v. *Lagunas Nitrate Syndicate*, (1899) 2 *Ch. D.* 392). In one other case it was decided that whether the directors have or have not been guilty of negligence can only be determined on the facts of each particular case and that the negligence aimed at must be in a business sense culpable or gross (*In Re. National Bank of Wales*, (1899) 2 *Ch.* 629).

In one case where the directors lent money within their powers but it turned out to be an imprudent loan *Lord Natherly, L. C.*, stated that :—

> "Whatever may have been the amount lent to anybody, however, ridiculous and absurd their conduct might seem, it was the misfortune of the company that they chose such unwise directors, but so long as they kept within the powers of their deed, the Court could not interfere with the discretion exercised by them." (*Turquand* v. *Marshall* (1869) 4 *Ch. App.* 376).

This proposition was improved upon by the same judge in another case, *viz., Overend Gurney & Co.* v. *Gibb,* (1872) *L. R.* 5 *H. L.* 480 where his Lordship pointed out that :—

"He certainly never intended to lay down the strong proposition that a person acting for another as his agent, is not bound to use all the ordinary prudence that can be properly and legitimately expected from any person in the conduct of the affairs of the world, *viz.,* the same amount of prudence which in the same circumstances he would exercise on his behalf."

While deciding the question of liability of directors the point to be remembered is not necessarily the fact that constructive notice of facts appeared in the books of the company, unless it is proved that he was actually aware of them (*Coasters, Ltd.,* (1911) 103 *L. T.* 632). These principles are subject to this one important exception, *viz.,* that an error of judgment or unjudicious payment may be one thing but an action without proper enquiry or a payment under similar circumstance would be another, and thus, if a director signed a cheque it would be his duty to acquaint himself with the fact or reasons why the said cheque was required to be paid. He would not be justified in taking for granted that the signing being a ministerial act it was not his duty to go in detail. He would not be protected even if he alleged that he signed it trusting his brother director (*Joint Stock Discount Co.* v. *Brown,* (1869) 8 *Eqt.* 381). We have seen that it was held in the *City Equitable Fire Insurance Case* that non-attendance at board meetings was not negligence. This principle is a very old one and is to be found in many old cases. The only exception is where the articles may expressly require the directors to attend every board meeting (*Charitable Corporation* v. *Sutton,* (1742) 2 *Atk.* 400). The directors who are absent for years from meeting were held not liable for negligence (*Re. Denham (Charles) & Co.,* (1883) 25 *Ch. D.* 752; *Marquis of Bute's Case,* (1892) 2 *Ch.* 190).

MISFEASANCE AND BREACH OF TRUST

We have already noticed, in detail, the various acts which involved a liability for directors and officers to make good or to account for money which they have either misapplied or wrongfully received from each in a fiduciary capacity they are liable to account for. Proceedings for misfeasance can be brought also against *de facto* directors (*Coventry and Dixon's Case*, (1880) 14 *Ch. D.* 660). These misfeasance proceedings are provided for under Sec. 235 of the Indian Companies Act, 1913. The section lays down that where in course of winding up the company, it appears that any person was taking part in the formation of the company or any past or present director, manager or liquidator, or any officer of the company has misapplied or retained or become liable or accountable for any money or property of the company, or being guilty of any misfeasance or breach of trust in relation to the company, the Court on the application of the liquidator or of any creditor or contributory *may within three years from the date of the first appointment of a liquidator in the winding up or of the misapplication, retainer, misfeasance or breach of trust, as the case may be, whichever is longer,* examine into the conduct of the promoter, and director, manager, liquidator or officer and compel him to repay or restore the money or property or any part thereof respectively with interest at such rate as the Court thinks just, or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance or breach of trust as the Court thinks just. It is further laid down that this section shall apply notwithstanding that the offence is one for which the offender may be criminally responsible. It will be noticed that the words in italics were added by the Indian Companies (Amendment) Act of 1936 with a view to fix the date from which the limitation was to begin and also the period of limitation because on this question there have been conflict of opinions between our Indian High Courts which conflict

is now thus set at rest. In case of liquidation, the amendment permits a period of three years for the application commencing from the date of the first appointment of the liquidator. There are other cases of misfeasance, for example, negligence, which has resulted in a loss of assets to the company, which may make them answerable to the company for damages. Of course, a director is only liable where he has participated in the misapplication and was concerned in it, he would not be liable if he was not aware of this wrongful act or if he did not take part in the affair. We have already seen that if one of the several directors was concerned in a misapplication of the company's funds and therefore guilty of misfeasance and breach of trust which made him pay damages by way of restitution, he would have a right to recover contributions from other directors and officers who were jointly liable with him. The directors who combined in such acts, are jointly and severally liable (*In Re. Forest of Dean Coal Mining Co.*, (1878) 10 *Ch. D.* 450; *Leads Estates, Building and Investment Co.* v. *Shepherd*, (1887) 36 *Ch. D.* 787; *Masonic and General Life Assurance Co.* v. *Sharpe*, (1892) 1 *Ch.* 154). Of course, only those actually implicated are liable (*Weir* v. *Barnett*, (1877) 3 *Ex. D.* 32). In one Allahabad case it was decided that an award in misfeasance proceedings against manager or auditor, etc., for fraud does not bar suit for damages against private persons who also contributed to the fraud. (*Deharadun-Mussorie Electric Tramways Co.*, (*in liquidation*) v. *Hansraj and others*, (1936) 58 *All.* 342). We have also seen that if the directors make profit for themselves they would be guilty of misfeasance if the said profits were secretly made. The directors are also not permitted to enter into contracts with the company unless the articles allow it or unless the company in general meeting consent to the act. If they had entered into contracts they would also be guilty of misfeasance. The principle here is that to make such contracts places the directors into the position

where their interests are in conflict with their duty (*Benson* v. *Heathorn,* (1842) 1 *Y. & C. Ch. Cas.* 326).

There have been good many cases under varying circumstances in which directors have been charged or made liable for misfeasance and breach of trust, such as *Rance's Case,* (1871) *L. R.* 6 *Ch. App.* 104 where a director was ordered to replace bonuses improperly paid to him out of his own pocket. There are many cases where the directors were ordered to replace dividends out of their own pocket which they had improperly paid to the shareholders out of the capital of the company, such as (*Re. Sharpe,* (1892) 1 *Ch.* 154; *London and General Bank,* (1895) 2 *Ch.* 116; *Flitcroft's Case,* (1882) 21 *Ch. D.* 519; *Denham & Co.,* (1883) 25 *Ch. D.* 752). In *Carriage Co-operative Supply Association,* (1884) 27 *Ch. D.* 322 orders were made against directors who had obtained qualification shares improperly from promoters or vendors (See also *De Ruvigne's Case,* (1877) 5 *Ch. D.* 306; *Pearson's Case,* (1877) 5 *Ch. D.* 336; *Mitcalfe's Case,* (1879) 13 *Ch. D.* 169; *Carriage Co-operative Association,* (1884) 27 *Ch. D.* 322). Similarly in another case where a director held his qualification shares as trustee for the promoter (*London and South Western Canal,* (1911) 1 *Ch.* 346). In *Boston Deep Sea Fishing & Ice Co.* v. *Ansell,* (1888) 39 *Ch. D.* 339, the managing director was held liable for receiving secret commission. In *Alexander* v. *Automatic Telephone Co.,* (1900) 2 *Ch.* 56, directors were held liable for not making calls on themselves. In *George Newman & Co.,* (1895) 1 *Ch.* 674, a director was held liable for making present to himself without the sanction of the company's articles. In *Stringer's Case,* (1869) *L. R.* 4 *Ch. App.* 475, the directors were made to repay out of their pocket dividend paid under a delusive or misleading balance sheet. An order was made compelling director who had obtained from promoter a secret advantage to account to company in *Archer's Case,* (1892) 1 *Ch.* 392. In *Marzetti's Case,* (1880) *W. N.* 50, the director was ordered to repay sums

nominally paid for preliminary expenses which were in fact paid for rigging the market. A director held liable where by fraudulent misrepresentation be induced the other directors to advance him money on insufficient security (*Exploring Land & Minerals Co.* v. *Kolckmann,* (1905) 94 *L. T.* 234). This case also deals with measure of damages. If directors deliberately fail to make inquiries as a result of an undertaking between them as to the price paid to each of them for the property sold by them to the company they are guilty of a gross dereliction of duty (*Coats* v. *Cronland,* (1904) 20 *T. L. R.* 800). It is also held that where there has been misfeasance or breach of trust there is no right of set-off as far as the delinquent directors are concerned (*Flitcroft's Case,* (1882) 21 *Ch. D.* 519; *In re. Anglo-French Co-operative Society,* (1882) 21 *Ch. D.* 492; *In re. Carriage Supply Association,* (1884) 27 *Ch. D.* 322).

Even though a director did not participate in a misconduct, his knowledge and sanction of same by the brother directors would make him liable (*Land Credit Co.* v. *Lord Fermoy,* (1870) 5 *Ch.* 73; *Montrotier Asphalte Co.,* (1876) 34 *L. T.* 716). If a director drew a cheque along with others for a lawful purpose and the same was misapplied, he would not be liable as was decided in the above case. In another case where a director had agreed to a course of practice which resulted in loss, it was held that he was not responsible because he had not taken any part in the misapplication (*Cullerne* v. *London & Suburban B. Society,* (1890) 25 *Q. B. D.* 485). When directors are given power to invest monies they need not necessarily invest in trust securities (*Burland* v. *Earle,* (1902) *A. C.* 83). With regard to secret profits by directors the leading case is that of *Parker* v. *McKenna,* (1874) 10 *Ch.* 96. A director who sold his property to the company without disclosing same was held guilty of misfeasance for non-disclosure (*In re. Cape Breton Co.,* (1885) 29 *Ch. D.* 795; *on appeal subnom Cavendish Bentinck* v. *Fenn,* (1887) *L. R.* 12 *App. Case* 652). Thus

misfeasance is not every type of misconduct but some act of misfeasance in the nature of a breach of trust. This refers to something which the director or officer has done wrongly, by misapplication or retaining in his own hands any money of the company or by which the company's property has been wasted or the company's credit improperly pledged. It must be something resulting in actual loss to the company (*Coventry & Dickson's Case*, (1880) 14 *Ch. D.* 660 *on page* 670, *see also Bentinck* v. *Fenn*, (1888) 12 *App. Case at page* 652; *in re. Etick*, (1928) 1 *Ch.* 861). Any breach of duty on the part of a director or officer resulting in the misapplication of assets of the company would amount to misfeasance (*Kingston Cotton Mill Co., No.* 2, *in re.* (1896), *at pages* 283, 288 *and* 291). In all cases of misfeasance, loss of money to the company must be proved as was decided in *Bentinck* v. *Fenn* cited above. It may also include deliberate sale of the property of the company at less value than it would otherwise fetch (*New Travellers Chambers*, (1895) 12 *T. L. R.* 529; *Park Gate Waggon Co.*, (1881) 17 *Ch. D.* 239).

In a recent case, *viz.*, *Liaquat Husain* v. *Official Liquidator*, (1933) *All.* 250 it was laid down that misfeasance proceeding under Sec. 235 of the Companies Act was merely an examination by the Court into the conduct of an officer of the company and as a result of that examination the Court may order an officer to restore the money or the property of the company as the Court may think just. Such proceedings cannot be said in any way to be a suit or other legal proceeding within the meaning of Sec. 280 of the Act. In this case the Official Liquidator applied for misfeasance proceedings against one of the original directors on which the latter applied for security for his costs to be furnished by the Official Liquidator. The Court held that the said director was not entitled to demand security. Besides it was the Court's opinion that any rule that the liquidator should furnish security for cost in misfeasance proceeding would also be

opposed to public policy, because want of funds may render it impossible for him to apply for such proceedings and this want of funds may be entirely due to the fraudulent misappropriation from persons sought to be proceeded against. In one case where a company was floated as a permanent fund company and started a separate branch which they called deposit branch, in which branch they did ordinary banking business which was *ultra vires* the company receiving deposits and advancing loan, ultimately the company sustained losses and was put into compulsory liquidation by an order of the Court. The depositors in the branch took out a misfeasance summons under Sec. 235 of the Companies Act alleging breaches of trust and demanding from officers and directors of the company repayment of money lost. The Court held that the depositors were not creditors in the eye of law, inasmuch as the banking business carried on by the company was an *ultra vires* transaction and consequently the misfeasance summons could not be entertained at their instance (*In re. Kolandaivelu Mudaliar,* (1931) 6 *Mad. L. J.* 270).

There was a similar case decided by the House of Lords in England, *viz., Sinclair* v. *Brougham,* (1914) *A. C.* 398 where in case of a building society, deposits were taken on the footing of a bank which was declared to be *ultra vires* business. On compulsory winding up the question of priority between outside creditors and bank customers on current and deposit account arose; the Court held that the depositors in connection with the banking part of the business were not entitled to recover moneys paid by them on an *ultra vires* contract of loan on the footing of money had and received by the society to their use. Thus on the principles laid down *in re. Hallett's Estate,* (1880) 13 *Ch. D.* 696 the Court ordered that the assets remaining after payment of the outside creditors must be taken to represent any part moneys which the depositors could follow, as having been invalidly borrowed, and any part moneys which the society

could follow, as having been wrongfully liable by its agents in the banking business, that this money ought to be distributed *pari passu* between the depositors and the unadvanced shareholders according to the amounts respectively credited to them in the books of the society at the commencement of the winding up.

Criminal Liability of Directors

Apart from the liability under criminal law, *i.e.*, Indian Penal Code, the Indian Companies Act contains special sections in connection with the liability of directors. These are as follows :—

Sec. 236. If any director, manager, officer or contributory of any company being wound up destroys, mutilates, alters or falsifies or fraudulently secretes any books, papers or securities or makes, or is privy to the making of any false fraudulent entry in any register, book of account or document belonging to the company with intent to defraud or deceive any person, he shall be liable to imprisonment for a term which may extend to seven years and shall also be liable to fine.

Prosecution of Delinquent Directors

Sec. 237 (1). *If it appears to the Court in the course of a winding up by, or subject to the supervision of the Court that any past or present director, manager or other officer, or any member, of the company has been guilty of any offence in relation to the company for which he is criminally liable, the Court may, either on the application of any person interested in the winding up or of its own motion, direct the liquidator either himself to prosecute the offender or to refer the matter to the registrar.*

(2). *If it appears to the liquidator in the course of a voluntary winding up that any past or present director, manager or other officer, or any member of the company has been guilty of any offence in relation to the company for which he is criminally liable, he shall forthwith report the matter to the registrar and shall furnish to him such information and give to him such access to and facilities for inspecting and taking copies of any documents, being information or documents in the possession or under the control of the liquidator relating to the matter in question, as he may require.*

(3). *Where any report is made under sub-section* (2) *to the registrar, he may, if he thinks fit, refer the matter to*

the Local Government for further inquiry, and the Local Government shall thereupon investigate the matter and may, if they think it expedient, apply to the Court for an order conferring on any person designated by the Local Government for the purpose with respect to the company concerned all such powers of investigating the affairs of the company as are provided by this Act in the case of a winding up by the Court.

(4). If on any report to the registrar under sub-section (2) it appears to him that the case is not one in which proceedings ought to be taken by him, he shall inform the liquidator accordingly, and thereupon, subject to the previous sanction of the Court, the liquidator may himself take proceedings against the offender.

(5). If it appears to the Court in the course of a voluntary winding up that any past or present director, manager or other officer, or any member, of the company has been guilty as aforesaid, and that no report with respect to the matter has been made by the liquidator to the registrar, the Court may, on the application of any person interested in the winding up or of its own motion, direct the liquidator to make such a report, and on a report being made accordingly, the provisions of this section shall have effect as though the report has been made in pursuance of the provisions of sub-section (2).

(6). If, where any matter is reported or referred to the registrar under this section, he considers that the case is one in which a prosecution ought to be instituted, he shall place the papers before the Advocate General or the public prosecutor and if advised to do so institute proceedings, and it shall be the duty of the liquidator and of every officer and agent of the company past and present (other than the defendant in the proceedings) to give him all assistance in connection with the prosecution which he is reasonably able to give :

Provided that no prosecution shall be undertaken without first giving the accused person an opportunity of making a statement in writing to the registrar and of being heard thereon.

For the purposes of this sub-section, the expression 'agent' in relation to a company shall be deemed to include any banker or legal adviser of the company and any person employed by the company as auditor, whether that person is or is not an officer of the company.

(7). If any person fails or neglects to give assistance in manner required by sub-section (6), the Court may, on the application of the registrar, direct that person to comply with the requirements of the said sub-section, and where any such application is made with respect to a liquidator, the Court may, unless it

appears that the failure or neglect to comply was due to the liquidator not having in his hands sufficient assets of the company to enable him so to do, direct that the costs of the application shall be borne by the liquidator personally.

The above Section 237 is an adaptation of a similar section in the English Companies Act of 1929 which was inserted on the recommendation of the Greene Commission of 1925-26.

Penalty for False Evidence

In this connection Sec. 238 lays down as follows :—

"If any person, upon any examination upon oath authorised under this Act or in any affidavit, deposition or solemn affirmation, in or about the winding up of any company under this Act, or otherwise in or about any matter arising under this Act, intentionally gives false evidence he shall be liable to imprisonment for a term which may extend to seven years, and shall also be liable to fine."

Penal Provisions

The Indian Companies (Amendment) Act of 1936 has added an additional section, *viz.*, Sec. 238A to our Act which lays down in detail a number of penal provisions which are of considerable importance. The section follows Sec. 275 of the English Companies Act and provides for the punishment of offences antecedent to or in course of winding up. Section 238A runs as follows :—

(1) If any person, being a past or present director, managing agent, manager or other officer of a company which at the time of the commission of the alleged offence is being wound up, whether by or under the supervision of the Court or voluntarily, or is subsequently ordered to be wound up by the Court or subsequently passes a resolution for voluntarily winding up.

(a) does not to the best of his knowledge and belief fully and truly discover to the liquidator all the property, real and personal, of the company, and how and to whom and for what consideration and when the company disposed of any part thereof, except such part as has been disposed of in the ordinary way of the business of the company; or

(b) *does not deliver up to the liquidator, or as he directs, all such part of the real and personal property of the company as is in his custody or under his control, and which he is required by law to deliver up; or*

(c) *does not deliver up to the liquidator, or as he directs, all books and papers in his custody or under his control belonging to the company and which he is required by law to deliver up; or*

(d) *within twelve months next before the commencement of the winding up or at any time thereafter conceals any part of the property of the company to the value of one hundred rupees or upwards or conceals any debt due to or from the company; or*

(e) *within twelve months next before the commencement of the winding up or at any time thereafter fraudulently removes any part of the property of the company to the value of one hundred rupees or upwards; or*

(f) *makes any material omission in any statement relating to the affairs of the company; or*

(g) *knowing or believing that a false debt has been proved by any person under the winding up, fails for the period of a month to inform the liquidator thereof; or*

(h) *after the commencement of the winding up prevents the production of any book or paper affecting or relating to the property or affairs of the company; or*

(i) *within twelve months next before the commencement of the winding up or at any time thereafter, conceals, destroys, mutilates or falsifies, or is privy to the concealment, destruction, mutilation or falsification of any book or paper affecting or relating to the property or affairs of the company; or*

(j) *within twelve months next before the commencement of the winding up or at any time thereafter makes or is privy to the making of any false entry in any book or paper affecting or relating to the property or affairs of the company; or*

(k) *within twelve months next before the commencement of the winding up or at any time thereafter fraudulently parts with, alters or makes any omission in, or is privy to the fraudulent parting with, altering or making any omission in, any document affecting or relating to the property or affairs of the company; or*

(l) *after the commencement of the winding up or at any meeting of the creditors of the company within twelve*

months next before the commencement of the winding up, attempts to account for any part of the property of the company by fictitious losses or expenses; or

(m) has within twelve months next before the commencement of the winding up or at any time thereafter, by any false representation or other fraud, obtained any property for or on behalf of the company on credit which the company does not subsequently pay for; or

(n) within twelve months next before the commencement of the winding up or at any time thereafter, under the false pretence that the company is carrying on its business, obtains on credit, for or on behalf of the company, any property which the company does not subsequently pay for; or

(o) within twelve months next before the commencement of the winding up or at any time thereafter pawns, pledges or disposes of any property of the company which has been obtained on credit and has not been paid for, unless such pawning, pledging or disposing is in the ordinary way of the business of the company; or

(p) is guilty of any false representation or other fraud for the purpose of obtaining the consent of the creditors of the company or any of them to an agreement with reference to the affairs of the company or to the winding up;

he shall be punishable, in the case of the offences mentioned respectively in clauses (m), (n) and (o) of this sub-section, with imprisonment for a term not exceeding five years, and, in the case of any other offence, with imprisonment for a term not exceeding two years.

Provided that it shall be a good defence to charge under any of clauses (b), (c), (d), (f), (n) and (o), if the accused proves that he had no intent to defraud and to a charge under any of clauses (a), (h), (i) and (j), if he proves that he had no intent to conceal the state of affairs of the company or to defeat the law.

(2) Where any person pawns, pledges or disposes of any property in circumstances which amount to an offence under clause (o) of sub-section (1) every person who takes in pawn or pledge or otherwise receives the property knowing it to be pawned, pledged or disposed of in such circumstances as aforesaid shall be punishable with imprisonment for a term not exceeding three years.

False statements in balance sheets Report Certificate and other Documents.

Sec. 282 of the act lays down as follows:—

Whoever in any return, report, certificate, balance-sheet or other

document, required by or for the purposes of any of the provisions of this Act, wilfully makes a statement false in any material particular, knowing it to be false shall be punishable with imprisonment of either description for a term which may extend to three years, and shall also be liable to fine.

It will be seen from the above section that if in case of a balance sheet, report or any return or any other document required by the Act a wilfully false statement is made on a material point it creates an offence. Some questions have arisen in actual practice as to how far and under what circumstances the balance sheet of a company would be false. This point will be dealt with later under the heading of "False or misleading balance sheet" in the chapter dealing on "Accounts and Audits."

The above sections deal with criminal offences which come to light in course of winding up, and it has been held that the offence under any of these sections may be an offence under the Indian Penal Code (*Queen Empress* v. *Moss,* (1894) *I. L. R.* 16 *All.* 88). A misleading declaration under Sec. 103 (i) (c) to enable a company to commence business is within the Sec. 282 *Emperor* v. *Bhose,* (1924) *I. L. R.* 46 *All.* 218.

With reference to Sec. 282, where as we have seen above punishment is provided for wilfully making a statement false in any material in any return, report, certificate, balance sheet or other document, it has been laid down *in re. P. D. Shamdasani,* (1929) *B. L. R.* 1144 that Sec. 282 of the Indian Companies Act, 1913, requires that false statements in a balance sheet should be made wilfully knowing them to be false. Thus where the points involved are really technical matters of correct or incorrect accounting, they do not normally fall within a criminal charge under this section, at any rate where no dishonesty or motive for dishonesty is shown, and where in certain particulars the directors have acted on the advice of counsel. It was also pointed out that generally speaking, the Police Court is not the proper forum to fight out disputed questions of finance in big companies or banks. In the opinion of the Court, that should be done in a Civil Court as the decision of the Civil Court is binding on the parties and can order refund of improper receipts the question of misleading or false balance sheet, with cases bearing on the subject has been fully dealt in chapter on Accounts and Audits which may be referred to in the Index.

In England, a prospectus has been held to be a "written statement" and directors have been prosecuted for publishing false

statement in the prospectus. Our Sec. 282 also refers to "other documents required by or for the purposes of any of the provisions of the Companies Act" the leading English cases in this connection are *Queen* v. *Gurney,* reported Finlason, in special report on case page 254 and *R.* v. *Kylsant,* (1932) 1 *K. B.* 442. In these cases the directors have been prosecuted and convicted. In case of directors who pay dividends out of capital, besides their Civil liability, they may be liable for conspiracy (*Burns* v. *Pennell,* (1849) 2 *H. L. C.* 497; *R.* v. *Esdaile,* (1858) 1 *F. & F.* 213). A case directly under the English Act of 1929, Sec. 362 corresponding to our Sec. 282 is *Reg.* v. *Tyler,* (1891) 2 *Q. B.* 588).

Where the directors committed a conspiracy to procure by fraud and falsehood the shares of a company to be quoted in the Official List of the Stock Exchange and thus gave a fictitious value for same, they had committed a punishable offence (*R.* v. *Aspinall,* (1876) 2 *Q. B. D.* 48).

THE REMEDY FOR MISFEASANCE OR BREACH OF TRUST

The civil remedy of a company against the delinquent director for breach of trust or misfeasance, negligence or fraud is by a suit, when the company is a going concern. Whereas when the company is in the course of winding up, Sec. 235 of the Indian Company's Act we have considered above in some detail gives a speedy and effective remedy.

The section may be made use of by the official liquidator, as it provides a summary procedure in lieu of a procedure by a suit, for recovery of assets or damages or compensation. Under this section besides the directors, promoter, manager, liquidator, or any officer, or even an auditor, or secretary, may be proceeded against, because under Sec. 2 (11) an officer includes director, manager, or secretary, and in case of Secs. 235 and 237 an auditor also. Besides the liquidator a creditor or contributory may also apply, but the contributory can only apply if he can show that he might derive some benefit thereby (*Cavendish Bentinck* v. *Fenn,* (1887) 12 *App.* 652). Here there must be something in the nature of a breach of duty or neglect, which causes pecuniary loss to the company, which breach

of duty will include misfeasance or breach of trust. It has also been held that the proceeding under this section can be brought mainly against directors and also against *de facto* directors (*Coventry & Dixon's Case,* (1880) 14 *Ch. D.* 660).

Claims under Sec. 235 can be sold or mortgaged as they were held to be "things in action" of the company and could be assigned by the official liquidator. Thus where they are sold or the company has no interest in equity of redemption the liquidator cannot proceed under the section without the consent of the purchaser or the mortgagor (*In re. Park Gate Waggon Works Co.,* (1881) 17 *Ch. D.* 243; *Anglo-Austrian Printing and Publish Union,* (1895) 2 *Ch.* 891).

With regard to liquidator taking action under this section, if he has any doubt he can ask the opinion of the Court, for the matter is of a judicial nature and not of a departmental nature (*Re. New Zealand Loan and Agency Co.,* (1895) 71 *L. T.* 693).

A liquidator generally cannot be ordered to give security as costs of a misfeasance summons but he may be ordered to pay costs personally in a proper case (*Strand Wood Co.,* (1904) 2 *Ch.* 1; see also *Brazilian Rubber Plantation,* (1911) 1 *Ch.* 425). A liquidator will generally not be required to make an affidavit of documents though the respondent to the summons should apply for inspection of necessary documents to the liquidator (*Mutual Society,* (1883) 22 *Ch. D.* 714). A policy-holder as a creditor can apply under the section (*British Guardian Life Assurance Co.,* (1880) 14 *Ch. D.* 335). In case of a contributory, who had become a bankrupt and has thus ceased to be a contributory he cannot apply even though his name is on the list of contributories under this section (*Cape Breton Co.,* (1881) 19 *Ch. D.* 77).

Rules of the Supreme Courts in India, excepting the Rangoon Supreme Court, contain no regulation laying down the procedure to be followed under Sec. 235. The proceedings are usually commenced by a summons in chamber, commonly known as misfeasance summons,

which is to be supported by an affidavit (For Form of the misfeasance summons and an affidavit see Vol. II Appendix B.). The summons under Sec. 235 against directors for misfeasance or breach of trust in relation to the company should state the grounds on which it is suggested that the matters complained of constitute a wrongful act or misfeasance for which the directors are responsible. In case the alleged misfeasance is an act which is not *ultra vires* the company and not fraudulent or dishonest directors are not liable unless it can be proved that they failed to exercise their judgment and discretion and that the omission to do so resulted in a loss or damage to the company (*In re. New Masona Land Exploration Co.*, (1892) 3 *Ch. D.* 577). Two claims one for misfeasance and the other for a declaration that the respondents are liable as contributory can be combined in a summons where such a combination is not embarrassing (*Wragg Ltd.*, (1897) 1 *Ch.* 796). A summons can be taken out against any one of the parties liable without summoning the others (*British Guardian Life A. Co.*, (1880) 14 *Ch. D.* 335), Diplomatic privilege can be successfully pleaded in answer to a misfeasance summons (*Bolivia (Republic of) Exploration Syndicate,* (1914) 1 *Ch.* 139; *Deckinson* v. *Delsolar,* (1929) 45 *T. L. R.* 637).

Where the Court can dispose of this summons in chambers, it will do so, but where evidence has to be taken, it is usually adjourned into Court. Of course in case of misfeasance summons the onus of proving the case is entirely on the applicant (*Hansraj* v. *Lahore Bank Ltd.*, (1915) *P. R. No.* 60 *p.* 265). When the directors are declared to be liable on the summons, the usual declaration is that they are jointly and severally liable for the payment to be made and, in case the auditor is also made liable, he will be declared to be liable both severally and jointly with the directors (*The Union Bank, Allahabad, Ltd.,* (1925) 42 *All.* 669).

Where a director has not himself misapplied the company's money, he is not liable under this section,

unless the knowledge of the breach of trust by misplacement of brother directors or officers can be brought home to him (*Kumarpuram* v. *Pestonji*, (1903) 5 *Bom. L. R* 633; *Jadu* v. *Ashutosh*, (1902) 29 *Cal.* 688; *Dovey* v. *Cory*, (1901) *A. C.* 477; *Prefontaine* v. *Grenier*, (1907) *A. C.* 101 (*P.C.*). A director is not liable for an act done at a meeting when he was not present, simply because he voted at a subsequent meeting for confirmation of minutes (*Burton* v. *Bevan*, (1908) 2 *Ch.* 240). The liability for breach of trust does not cease by death or discharge in insolvency of a delinquent director (*Ramskill* v. *Edwards*, (1886) 31 *Ch. D.* 100). In case of negligence, however, the liability does not survive against his estate, unless the money came into his possession (*New Flemming S. & W. Co., Ltd.* v. *Kessowji*, (1885) 9 *Bom.* 373; *Overend* v. *Gurney*, (1869) 4 *Ch. Ap.* 701).

Defences and Limitations

The officer against whom misfeasance proceedings are taken may, without going into facts, take a summons asking that misfeasance proceedings against him may be stayed because he is not an officer (*Re. Western Counties Steam Bakeries & Milling Co.*, (1897) 1 *Ch.* 617 : *Kingston Cotton Mill Co.*, (1896) 1 *Ch.* 6). The other defence will be where all parties have knowledge of and have acquiesced in the transaction, because here no liability for misfeasance would attach (*Re. Innes & Co. Ltd.*, (1903) 2 *Ch.* 254; *Re. British Seamless Paper Box Co.*, (1881) 17 *Ch. D.* 467; *Attorney General for the Dominion of Canada* v. *The Standard Trust Co. of New York*, (1911) *A. C.* 498).

We have of course seen the defences to the case where there is an article exempting directors from negligence and default in the articles of association of the company concerned. Of course the extent of the protection depends upon the terms of the particular article and each case has to be decided on its own merit (*City of London Insurance Co.*, (1925) 41 *T.L.R.* 521).

There is, however, another defence, namely, that on

the ground of limitation in applications by liquidators for misfeasance against directors and other officers. Prior to the passing of the Indian Companies (Amendment) Act of 1936 there was great conflict of decisions on this point but Sec. 235 as amended by the above act now finally lays down to the effect that in case of misfeasance or breach of trust in relation to the company the Court may on application of the liquidator or of any creditor or contributory *made within three years from the date of the first appointment of a liquidator in the winding up or of the misapplication, retainer misfeasance or breach of trust, as the case may be, whichever is longer*, examine into the conduct of the promoter, director, manager, liquidator or officer and compel him to repay or restore the money or property or any part thereof respectively with interest at such rates as the Court thinks just or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer misfeasance or breach of trust. Thus it will be seen that the old Sec. 235 (3) which used to apply the Limitation Act to these misfeasance applications has been omitted because it was found in practice that under it delinquent directors in many cases succeeded in evading their civil liability under the said section. Now the amended Sec. 235 (1) allows three years for the making of an application dating from the first appointment of a liquidator. The old decisions bearing on this part of Bombay and Allahabad High Courts are therefore obsolete, *viz., Re. Govind Narayan Kakarde* v. *R. G. Rajopadhye,* (1930) 54 *Bom.* 226; *In the matters of Union Bank Allahabad, Ltd.,* (1925) 47 *All.* 669).

Directors' Remuneration

It has been held that the remuneration of directors must be specifically provided for in the articles of association, otherwise they will not be entitled to any remuneration (*Dunstan* v. *Imperial Gas. Co.,* (1832) 3 *B. & Ad.* 125; *Young* v. *Naval Society,* (1905) 1 *K. B.* 687; *Bos-*

choek Proprietary Co. v. *Fuke,* (1906) 1 *Ch.* 148). In the words of *Brown, L. J.* in *Hutton* v. *West Cork Railway,* (1883) 23 *Ch. D. at p.* 671). " A director is not a servant; he is a person doing business for the company, but not upon ordinary terms. It is not implied from the mere fact that he is a director that he is to be paid for it. Sec. 93 of the Indian Companies Act also requires the remuneration to be stated in the prospectus. When remuneration is fixed by the articles as is usual now-a-days in case of most of the articles they cannot take remuneration beyond what has been fixed (*Dikshit & Co.* v. *Mathura Prasad,* (1925) 47 *All.* 94). As a matter of fact if the directors were to take remuneration beyond that which is fixed by the articles it would amount to a breach of trust and would have to be refunded jointly and severally (*Whitehall Courts, Ltd.*, (1887) 56 *L. T.* 280).

Table " A " suggests a provision by which the remuneration may be fixed at a general meeting of the company. If such a clause happens to have been introduced in the articles of the company, the best course open to the directors is to call a general meeting of the shareholders or members of the company and get this question of remuneration settled. Once the remuneration is fixed either by the articles or by the general meeting it must be paid irrespective of the fact whether there are profits or not (*Re. Lundy Granite Co., Lewis' Case,* (1872) 26 *L. T.* 673). Of course this will not apply to cases where the remuneration is to be paid in the form of percentage of commission on profits or only out of profits. There may be a case where the articles are entirely silent on the question of remuneration in which case the general meeting must vote a remuneration before they are entitled to get any, but it has been held here that such a remuneration voted without a provision in the articles may only be paid out of profits and virtually speaking amounts to a gratuity and not a matter of right (*George Newman Co.,* (1895) 1 *Ch.* 674; *Ex parte, Cannon,* (1885) 30 *Ch. D.* 629).

Thus, generally speaking, the remuneration of directors

is a matter of internal arrangement and management (*Normandy* v. *Ind, Coope & Co., Ltd.,* (1908) 1 *Ch. D.* 84). Here according to *Kekewich, J.* "Apart from any prohibition in the memorandum of association. . . . . . it must be competent to the company to make a bargain with one of the directors, either for a reward to him for services rendered in the past, or for remuneration to him for services to be rendered in the future, to do this with or without consideration, and if consideration enters into bargain to accept any deemed adequate. Even if apparently extravagant, the pension or remuneration cannot be open to criticism, it being entirely a matter for the company to decide what is right to be done." The articles generally provide for the payment of a certain remuneration to be paid to the directors for services rendered and if not, they leave the same to be determined by the company in general meeting. In case the articles laid down or fixed a remuneration, the same must be disclosed in the prospectus of the company issued in connection with its first issue. In the absence of this special provision, the directors are not entitled to claim any remuneration either by *quantum meruit* or otherwise, unless the company, in general meeting, allows same to be paid out of profits. According to *Lindley L. J.,* "Directors have no right to be paid for their services, and cannot pay themselves or each other or make presents to themselves out of the company's assets, unless authorised so to do by the instrument which regulates the company, or by the shareholders, at a properly convened meeting. The shareholders, at a meeting duly convened for the purpose, can, if they think proper, remunerate directors for their trouble or make presents to them for their services out of assets properly divisible amongst the shareholders themselves. Further, if the company is a going concern, the majority can bind the minority in such a matter as this. But to make presents out of profits is one thing and to make them out of capital or out of money borrowed by the company is a very different matter" (*In Re. George Newman & Co.,* (1895) 1 *Ch. D.* 674).

This is because the question of their remuneration depends upon their agreement with the company, and in case any specific agreement is entered into, the articles must be looked into in order to ascertain the position. The general opinion however is that when a director is to receive remuneration at the rate of so much per annum, he will be entitled to a proportionate sum for a broken period (*Diamond* v. *English Sewing Cotton Co.,* (1922) *W. N.* 237), where the general meeting fixes the remuneration, the same commences from the date of the meeting at which the amount is fixed unless the resolution which fixes the remuneration provides otherwise (*London Gigantic Wheel Co.,* (1908) 24 *T. L. R.* 618). Of course a director's remuneration will not include his travelling expenses in addition to his remuneration unless specially provided for, nor will he be entitled to be paid free of income tax (*Young* v. *The Naval, Military & Civil Service, C. S. of S. Africa,* (1905) 1 *K. B.* 687; *Boschoek Proprietary Co.* v. *Fuke,* (1906) 1 *Ch.* 148). Of course the director can sue for his fees or may prove the same with other creditors in winding up of a company (*Nell* v. *Atlanta Gold Co.,* (1894) 11 *T. L. R.* 407; *Beckwith's Case,* (1898) 1 *Ch.* 324). In order to avoid the confusion created through various differing decisions in connection with the apportionment of yearly remuneration fixed by the articles and payable to directors, the usual practice now where such remuneration is provided for in the articles is clearly to state that the said remuneration shall accrue *due de die in diem.* Liquidation puts an end to the service of a director (*Central de Kaap Gold Mines,* (1899) *W. N.* 216). There is a case however where service was allowed to continue after liquidation with a view to complete the year (*Shaws, Bryant & Co.,* (1901) *W. N.* 124).

In India the usual practice is to provide in the articles for a fee payable at each meeting and also to provide for extra remuneration for travelling expenses, etc., to the directors residing outside the town or centre where the meetings are held. It is also usual to provide by a

special article for the payment of extra remuneration to such one or more of directors for extra work done as may be decided upon by the board of directors as a body.

If the directors pass a resolution to forego their fees or to postponement that will be binding on them as to future fees unless the resolution provides for their fees if they have earned the same also (*McConnell's Case,* (1901) 1 *Ch.* 728; *Re. Consolidated Nickel Mines,* (1914) 1 *Ch.* 883). If however the appointment of the director turns out to be invalid he cannot recover his remuneration whether fixed by the articles or otherwise (*Woolf* v. *East Nigel Mining Co.,* (1905) 21 *T. L. R.* 660). If however an amount was paid to a director by mistake towards fee it may be recovered (*Re. Bodega Co.,* (1904) 1 *Ch.* 276). Though older decisions used to hold that the directors' claims for fees were postponed in liquidation to outside creditors the later cases have allowed a managing director who was a member of the company as well as the ordinary director when the articles fixed remuneration to prove his claim in liquidation in competition with ordinary creditors (*Re. Dale & Plant,* (1890) 43 *Ch. D.* 255; *Re. New British Iron Co., Ex parte Beckwith,* (1898) 1 *Ch.* 324; *Re. A1 Biscuit Co.,* (1899) *W. N.* 115). The old cases which declined to permit a director to prove for his fees in competition with ordinary creditors did so on the ground that they were also members. We have however seen that this view is now not followed. This rule however will not apply to a remuneration which was more or less a gratuity voted by the company and thus the directors cannot prove same in competition with ordinary creditors (*A1 Biscuit Co.,* (1899) *W. N.* 115; *Ex parte Cannon,* (1885) 30 *Ch. D.* 629). If the articles provide that the fees to the directors shall only be payable out of profits, then a resolution of the company to pay the said fee out of capital where there are no profits will not entitle the directors to their remuneration (*Whitehall Courts, Ltd.,* (1887) 56 *L. T.* 280). They would be entitled to receive fees out of profits which has been put to suspense

account immediately before winding up, but not out of profits made by selling the whole business and assets of the company in winding up (*Peruvian Guano Co.*, (1894) 3 *Ch.* 690; *Spanish Prospecting Co.*, (1911) 1 *Ch.* 92; *Frames* v. *Bultfontein Mining Co.*, (1891) 1 *Ch.* 140). There are some cases where the articles enable directors to renounce their fees. This power is hardly necessary. We have already seen that directors properly and lawfully appointed are entitled to the remuneration and thus *de facto* directors are not entitled to their remuneration though the company can, when they come in possession of all facts, ratify their appointment so as to entitle them from the time of their acting (*Woolf* v. *East Nigel Gold Mining Co.*, (1905) 21 *T. L. R.* 660; *Boschoek Proprietary Co.* v. *Fuke*, (1906) 1 *Ch.* 148). If, however, the articles provide for a remuneration, they would be entitled to claim the same because it has been held that where the directors agree to act as such and the articles provide for a share-qualification as well as remuneration the inference is that there is an implied agreement between the company and the directors to the effect, that, the directors shall take up and pay for the qualification shares as per the articles, on the one part, and that the company shall on the other part, pay him the remuneration provided for in the articles (*Isaac's Case*, (1892) 2 *Ch. D.* 158). Here, the articles will be referred to with a view to ascertain what the terms agreed upon for their remuneration were. In the words of *Cozens-Hardy, L.J.* "The articles, though not themselves a contract between the company and the director must be regarded as showing the terms upon which on the one hand he agrees to pay him remuneration for his services" (*Molineaux* v. *London, Birmingham and Manchester Insurance Co.*, (1902) 2 *K. B.* 596). In cases where the remuneration is fixed to be payable yearly there are a number of conflicting opinions but according to Gore-Brown (Joint Stock Companies, 35 Edn.) the resultant effect of all of them is that "a director's right to remuneration is not apportionable when the words conferring the

right give him so much per annum, whether or not he is liable to removable or entitled to resign." When the articles provided "the sum of £125 per annum per director" it was held that the articles did not entitle the directors to recover remuneration for any less period than a year (*Inman* v. *Acroyd & Best, Ltd.*, (1901) 1 *K. B.* 613). Also see (*Moriarty* v. *Regents' Garage & E. Co. Ltd.*, (1921) 2 *K. B.* 766). This principle *viz.*, that when a servant has agreed to serve for a fixed period for which a fixed amount is to be paid, he is not entitled to anything until he serves this period which is a condition precedent. was laid down over a century ago in *Cutter* v. *Powell,* (1795) 6 *T. R.* 320. They can themselves sue for their remuneration which is agreed upon impliedly or expressly (*Orton* v. *Cleveland, etc., Co.,* (1865) 3 *H. & C.* 868). Where a yearly remuneration is provided for, the same can be apportioned, but not otherwise (*Salton* v. *New Beeston Cycle Co.,* (1899) 1 *Ch. D.* 775; *Inman* v. *Acroyd,* (1901) 1 *K.B.* 613). They can prove for their remuneration as ordinary creditors in a winding up (*Beckwith's Case,* (1898) 1 *Ch.* 324). This remuneration shall not include travelling expenses of the directors unless expressly provided for. Again, where qualification shares are held by a director as a trustee on settled shares, the same belong to the estate but if, on the other hand, a person is appointed a director of a corporation by some other company whose director he also, was, and he transferred some of the shares of the first named company, which the said second company held in the name of this director with a view to give him the required qualification to act as the director of the first named corporation, this would not fall under the above rule, and unless otherwise agreed, he would be entitled to retain the benefit himself. This is because according to *Warrington, J.,* the right to a director's fees did not arise from the possession of the qualification shares. According to His Lordship, he obtained his fees by reason of the contract of service between him and the company for which he acted as a director (*Re. Francis Berrett* v.

Fisher, (1904) 74 *L. J. Ch.* 198; *Dover Coal Field Extension*, (1907) *W. N.* 119). The remuneration is not to be paid free of income-tax unless otherwise agreed upon. In case the director's remuneration is to depend upon the percentage of profit, he is not entitled to claim on that ground a percentage calculated on all the proceeds of the sale of the assets of the company unless there is an arrangement to that effect (*Frames* v. *Bultfontein Mining Co.*, (1891) 1 *Ch.* 140). It is sometimes provided that the remuneration is to be paid to the directors out of profits only, in which case it cannot be paid out of capital, but there is nothing to prevent its being paid out of capital. It is open to directors by a resolution to renounce the right to future remuneration (*McConnell's Case, Re. London and N. Bank*, (1901) 1 *Ch.* 728). Sometimes the articles provide for one sum to be paid for directors' remuneration and leave to the board of directors to apportion same among themselves. Here no director is entitled to claim anything until an apportionment is made (*Joseph* v. *Sonora* (*Maxico*) *Land Co.*, (1918) 34 *T. L. R.* 220). This, of course, applies to remuneration proper, but in case the shareholders vote a gratuity to the directors, the said gratuity will not be proveable in case of the liquidation of the company. In case the directors receive remuneration in excess of the amount payable to them it will amount to a "misfeasance," and the said excess will have to be refunded. Where a director is appointed also a receiver and manager on behalf of the debenture holders, he will be entitled to his remuneration in both the capacities, *viz.*, that of a director and a receiver (*South Western of Venezuela Railway*, (1902) 1 *Ch. D.* 701). The directors may, at their discretion, waive the whole part of the remuneration.

It may be added here that in case a percentage upon the "net profits" is payable to directors or managers as part or whole of their remuneration, the said "net profits" for the year in question were the excess of the receipts of the year over the current expenses and outgoings of the

same year—*i.e.*, fund which for that year was capable of being lawfully applied by the company to the payment of a dividend. This fund as a matter of law can only be arrived at after deducting excess profits duty which was a debt due by the company. No analogy between the incidence of income tax and that of excess profits duty exists (*Patent Castings Syndicate, Ltd.* v. *Etherington,* (1919) 2 *Ch. D.* 254).

Usual Clauses in the Articles of Indian Companies Re. Directors' Remuneration

The usual clauses in the articles for directors remuneration run as follows :—

FORM OF ARTICLE

The remuneration of every director shall be such sum not exceeding Rs. 200, as the directors may fix for every meeting of the Board attended by him.

An alternative clause is as follows :—

The remuneration of a director for his service shall be such a sum as may be fixed by the directors not exceeding rupees thirty for each meeting attended by him; and such additional remuneration as may be fixed by the directors may be paid to any one or more of their number for services rendered by him or them in signing the share certificates in respect of the company's original capital or any further or new issue thereof, or any debentures or debenture stock issued by the company, and the directors shall be paid such further remuneration (if any) as the company in general meeting shall, from time to time determine and in default of such determination within the year equally.

One other alternative clause is as follows :—

The remuneration of every director shall be Rs. 30, for every meeting of the board attended by him. The directors shall also be remunerated for any extra service done by them outside their duties as defined by these regulations. The directors shall also be paid any travelling expenses of attending and returning from meetings of the board (including hotel expenses) and any other expenses properly incurred in connection with the business of the company.

The other alternative clause is as follows :—

"The directors shall be paid out of the funds of the company by way of remuneration for their services such sums as the company in general meeting may from time to time determine and in default of such determination the remuneration of each director shall be a sum not exceeding Rs. 30 for every meeting of the board attended by him and the remuneration of the chairman shall be a sum not exceeding Rs. 50 for every such meeting."

The other alternative clause is as follows :—

"The remuneration of every director (including an *ex-officio* director or a permanent director) shall be such amount as may be fixed by the directors but not exceeding Rs. 30 for every meeting of the board attended by him and if no such amount is fixed by the Directors then Rs. 30 shall be deemed to be the fee prescribed for every attendance. The board of directors may however fix a higher remuneration for the chairman not exceeding Rs. 50 for every meeting attended by him."

Disqualification Vacation Removal and Resignation of Directors

Generally speaking the articles of association as has been suggested and indicated in Table "A" contain an article under which the directors are disqualified from acting under the following circumstances *viz.*, when :—

The office of a director shall *ipso facto* be vacated :—

(*a*) If he, not being a director *ex-officio* or the debenture director, ceases to hold the required amount of shares or stock to qualify him for office, or

(*b*) If he is adjudicated insolvent or suspends payment or makes an assignment for the benefit of his creditors or compounds with his creditors,

(*c*) If he is found to be of unsound mind by a Court of competent jurisdiction, or

(*d*) If he, absent himself from three consecutive meetings of the directors or from all the meetings of the directors for a continuous period of three months, whichever is the longer without leave of absence from the board of directors, or

(*e*) If he fails to pay calls made on him in respect of shares held by him within six months from the date of such

calls being made, or if he resigns his office by giving one month's notice in writing to the company of his intention so to do, or

(*f*) If he or any firm of which he is a partner or any private company of which he is a director accepts a loan or guarantee from the company in contravention of Sec. 86D of Indian Companies Act of 1913, or

(*g*) If he or any firm of which he is a partner or any private company of which he is a director without the sanction of the company in general meeting accepts or holds any office of profit under the company other than that of a managing director or manager or a legal or technical adviser or a banker, or

(*h*) If he, not being a director *ex-officio* or the debenture director, is requested in writing by all his co-directors to resign, or is removed from office by an extraordinary resolution of the company.

In absence of the above article under the old act a director could not be removed or disqualified from acting except in case of fraud. On strong representations on part of Shareholders' Association of Bombay the law has now been altered by the Indian Companies (Amendment) Act of 1936. *Now a company may by an extraordinary resolution remove any director, whose period of office is liable to determination at any time by retirement of directors in rotation, before the expiration of his period of office and may by ordinary resolution appoint another person in his stead. The person so appointed shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose place he is appointed was last elected director. It is further enacted that a director so removed shall not be reappointed a director by the board of directors [Sec. 86G (1)]. However this section is not made applicable to directors elected or appointed before the commencement of the Indian Companies (Amendment) Act of 1936 [Sec. 86G (2)].*

It may be added here that the words "whose period of office is liable to determination at any time by retirement of directors in rotation" have been inserted in the section with the dominant object of excluding directors

ex-officio appointed by managing agents as well as debenture directors who have been nominated by debenture holders or their trustees according to the terms of the issue from the compulsory retirement rule now introduced in the Act. It is also sought to exclude the directors that may have been nominated by persons purchasing large blocks of shares at the time of formation of companies and on the express condition that they would be given the power to nominate a director of their own.

There are articles empowering the company to remove directors by extraordinary or special resolutions. Here it is not necessary for the company to give any hearing to the director concerned in his own defence other than that which he would be entitled to as a member of the company (*Dean* v. *Bennett,* (1871) 6 *Ch.* 489; *Cassel,* v. *Inglis,* (1916) 2 *Ch.* 211).

Apart from the articles a director can always be dismissed for misconduct (*Boston Deep Sea Fishing Co.* v. *Ansell,* (1888) 39 *Ch. D.* 339). In case of dismissal for misconduct the director is entitled to be heard in his own defence and to have notice of what he is accused of (*Andrews* v. *Mitchell,* (1905) *A. C.* 78; *D'Arcy* v. *Adamson,* (1913) 29 *T. L. R.* 367). Of course in such cases the Court will not insist on matters being conducted strictly as in a Court of Justice (*Maclean* v. *Workers' Union,* (1929) 1 *Ch.* 602). (See Note under the Form of article for removal of director). Again as we have seen articles specifically provide that the directors shall hold qualification shares and if they cease to hold these shares or fail to acquire them within the time stipulated in the articles they naturally cease to act. Subject to anything contrary in the articles a director can resign his office at any time. It is usual for articles to insert a special clause to provide for this resignation. When the director does want to resign he has to give a written notice to the company which must be served on the authorities in the manner provided for by Sec. 148 of the Act.

In connection with the above eight circumstances

under which the director's office is said to be vacated it *may be stated that Sec. 86I of the Indian Companies (Amendment) Act of 1936 now enumerates them and makes vacation compulsory irrespective of the fact whether the articles provide for such vacation.* On the question of vacation of office on the ground of holding or accepting any office of profit it was held in one case where the director also acted as a paid trustee for debenture holders that this rule did apply and he was accordingly disqualified (*Astley* v. *New Tivoli Co.*, (1899) 1 *Ch.* 151). In another case where a secretary was appointed a director who continued to hold the office of secretary without any salary, it was held that this did not disqualify (*Iron Ship Coating Co.* v. *Blunt*, (1868) *L. R.* 3 *C. P.* 484).

With reference to the office being vacated on the director becoming a bankrupt or insolvent it has been held that if a person was a bankrupt at the time of his appointment he cannot be prevented from acting (*Dawson* v. *African Consolidated Co.*, (1898) 1 *Ch.* 6). This decision may not apply *under the Amending Act of 1936 because Sec. 86A now expressly provides that if any person being an undischarged insolvent acts as director or managing agent or manager of any company he shall be liable to imprisonment for a term not exceeding two years or to a fine not exceeding Rs. 1,000 or to both.* The object sought to be achieved here by the legislature was not only to punish an insolvent acting as a director, but also to disqualify him altogether from doing so. In view however of the decision in *Dawson* v. *African Consolidation Co.*, cited above, it is doubtful whether the actual construction of the section would bring about that result as there is nothing expressly stated there to the effect that an insolvent acting as a director or his appointment as such is void. Our Indian Sec. 86A no doubt adopts or follows Sec. 142 of the English Companies Act of 1929 but the wording has been altered considerably. Sec. 142 of the English Act is more carefully drafted and is sufficiently elaborate to cover the position.

Section 142 runs as follows :—

(1) If any person being an undischarged bankrupt acts as director of, or directly or indirectly takes part in or is concerned in the management of, any company except with the leave of the Court by which he was adjudged bankrupt he shall be liable to conviction on indictment to imprisonment for a term not exceeding two years, or on summary conviction to imprisonment for a term not exceeding six months or to a fine not exceeding five hundred pounds, or to both such imprisonment and fine;

Provided that a person shall not be guilty of an offence under this section by reason that he, being an undischarged bankrupt, has acted as director of, or taken part or been concerned in the management of, a company, if he was on the third day of August, nineteen hundred and twenty-eight, acting as director of, or taking part or being concerned in the management of, that company and has continuously so acted, taken part, or been concerned since that date and the bankruptcy was prior to that date.

(2) In England the leave of the Court for the purposes of the section shall not be given unless notice of intention to apply therefore has been served on the official receiver and it shall be the duty of the official receiver, if he is of opinion that it is contrary to the public interest that any such application should be granted, to attend on the hearing of and oppose the granting of the application.

(3) In this section the expression "company" includes an unregistered company and a company incorporated outside Great Britain which has an established place of business within Great Britain, and the expression "official receiver" means the official receiver in bankruptcy.

(4) Sub-section (1) of this section in its application to Scotland shall have effect as if the words "sequestration of his estates was awarded" were substituted for the words "he was adjudged bankrupt."

With reference to what amounts to insolvency or bankruptcy it has been held that it is not necessary that the person should have been adjusted bankrupt, but that there must be some declaration or admission of insolvency (*James* v. *Rockwood Colliery Co.*, (1912) 106 *L. T.* 128). The facts and admissions showing that the director knew that he could not meet his liabilities in full, would constitute the evidence of insolvency, on which the Court would declare a director disqualified (*London and Counties*

Assets Co. v. *Brighton Grand Concert Hall,* (1915) 2 *K. B.* 493). In another case a director was disqualified as an insolvent where he called a meeting of the creditors to whom he exhibited a statement of affairs showing liabilities in excess of assets because these facts were considered as sufficient evidence of insolvency to disqualify him (*Sissons & Co.* v. *Sissons,* (1910) 54 *Sol. J.* 802). Thus where the words, " becomes bankrupt " are used in the articles it means after election.

In case of the provision that in case he becomes a lunatic or becomes of unsound mind it is not necessary that the director should have been declared a lunatic by a Court of lunacy after investigation.

The other ground *viz.*, that of " absenting himself " means that the absence must be voluntary and absence through illness will not be a disqualification (*Meck's Claim,* (1900) *W. N.* 144; *McConnell's Case,* (1901) 1 *Ch.* 728).

We have already seen that a director can resign unless articles otherwise provide and when he so resigns his resignation becomes complete as soon as the notice is given and cannot subsequently be withdrawn even where it has not been officially confirmed or accepted (*Transport Ltd.* v. *Schomberg,* (1905) 21 *T. L. R.* 305; *Glossop* v. *Glossop,* (1907) 2 *Ch.* 370).

It should be noted that the happening of any of the events specified in the articles as a disqualification, results in the office being vacated *ipso facto* and that this fact cannot be ignored by the directors, in fact they have no power to do so (*Re. Bodega Co.,* (1904) 1 *Ch.* 276).

There is however a case where there were only two directors who were constantly disagreeing and thereby had created a deadlock. In such a case it was held that the company in general meeting could remove the directors and fill up vacancies (*Barron* v. *Potter,* (1914) 1 *Ch.* 895). If however the company removes a director by a resolution and though the resolution is ineffectual legally, the Court will not interfere to force him on the

company (*Harben* v. *Phillips,* (1883) 23 *Ch. D.* 14) and this will be the case even though there may be a contract to employ him for a specified time, because the remedy for such a breach of contract will be damages (*Bainbridge* v. *Smith,* (1889) 41 *Ch. D.* 462).

Where a director is excluded wrongly by the board of directors from attending board meetings he can move for an injunction against them on the ground of individual injury to himself (*Pulbrook* v. *Richmond Consolidated Mining Co.,* (1878) 9 *Ch. D.* 610; *Sarat Chandra* v. *Tarak Chandra,* (1924) *I. L. R.* 51 *Cal.* 916). Where the articles gave power to remove a director "for negligence or other reasonable cause" it was held to mean such cause as the company thought fit and reasonable (*Scottish Petroleum Co.,* (1883) 23 *Ch. D.* 413).

It may be further remembered that directors under the ordinary company law as we have already seen are disqualified by their office from contracting with the company but special clauses are inserted in the articles of companies now-a-days specifically stating to the effect that "no director shall be disqualified for the office on contracting with the company etc." We have already seen the model clauses in connection with that also.

The secretary of the company should keep a proper roll showing clearly the time when each director is due to retire in rotation. We have also seen that some articles describe directors, particularly in case of private limited companies, as life directors or permanent directors. In their case the articles must be altered by special resolution before any change in their appointment can be made.

Maximum and Minimum Number of Directors

It is usual for articles to state the maximum and minimum number of directors. Of course in case of a private limited company it is not compulsory to have directors at all, whereas in case of a public company the Act requires at least *three* directors.

Where the articles fix a minimum number of directors, a smaller number cannot act unless the articles also provide that they can act notwithstanding vacancies (*Alma Spinning Co.*, (1881) 16 *Ch. D.* 681; *Scottish Petroleum Co.*, (1883) 23 *Ch. D.* 413). Frequently articles are also provided for making acts valid notwithstanding any irregularity that may be subsequently discovered. In this case, if the act is done in good faith and under an impression by the directors that they had power to do the said act, the same shall be valid with the result that both the shareholders as well as strangers are bound by same (*Dawson* v. *African Consolidated Co.*, (1898) 1 *Ch.* 6; *British Asbestos Co.* v. *Boyd*, (1903) 2 *Ch.* 439; *Channel Collieries Trust* v. *Dover Railway Co.*, (1914) 2 *Ch.* 506). Again if the directors are not properly appointed, innocent strangers dealing with them would be entitled to treat them as agents of the company and the company will be bound by their acts (*County Life Assurance Co.*, (1870) 5 *Ch.* 288; *Re. Bank of Syria*, (1900) 2 *Ch.* 272 (1901) 1 *Ch.* 115). It has also been held that a meeting called by a board of directors which did not form a quorum may pass valid resolutions (*Southern Counties Deposit Bank* v. *Rider*, (1895) 73 *L. T.* 374).

De Facto Directors

De Facto directors are persons who though not duly appointed or in the appointment of whom there is some material defect, purport to act as such. The company for which these directors act may restrain them from acting in that capacity or from representing themselves falsely as directors. If any damage is incurred by the company through their action, the company can sue to recover same from them. We have already seen that actions of such *de facto* directors will be binding on the company in case of innocent third parties (*Imperial Mercantile Credit Association* v. *Coleman*, (1871) 6 *Ch.* 558; *Costa Rica Railway Co.* v. *Forewood*, (1900) 1 *Ch.*

756; *Ram Narain* v. *Ram Kishen,* (1911) 10 *I. C.* 505). This is also on the principle that it is not necessary for a third party to inquire whether the director is properly appointed and is entitled to assume that everything is in order so long as articles are silent (*Irvine* v. *Union Bank of Australia,* (1877) 2 *App. Ca.* 366).

In Sec. 83 (3) there is a presumption that the directors are validly appointed until the contrary is proved whereas, Sec. 86 of our Indian Act, 1913 clearly lays down the law on this subject as :—

> The acts of a director shall be valid notwithstanding any defect that may afterwards be discovered in his appointment or qualification : Provided that nothing in this section shall be deemed to give validity to acts done by a director after the appointment of such director has been shown to be invalid.

This section would apply also in cases where acts affecting members in their relation to the company and the relations of the members of the company *inter se* are concerned, such as where allotments of calls have been made by directors not regularly appointed (*Dawson* v. *African Consolidated Co.,* (1898) 1 *Ch.* 6; *Changa Mal* v. *Provincial Bank, Ltd.,* (1914) 36 *All.* 412). It will be noticed that in Sec. 86 there is a proviso by which the protection to outsiders becomes inapplicable in respect of acts done after the director's appointment has been proved to be defective, but until that happens, an outsider is protected from any loss and the company is bound to compensate him for any loss arising out of the acts of a *de facto* director (*Hope Mills Ltd.* v. *Sir Cowasji Jehangir,* (1911) 13 *Bom. L. R.* 162). As a precaution in most companies the articles of association are also made to embrace a clause similar in wording to the section quoted above with a view to make the honest actions of the *de facto* director good and binding. A *de facto* director may also be made to submit a statement as to the affairs of the company in course of the proceedings in winding up of the company (*New Par Consols,* (1898) 1 *Q. B.* 573) and proceedings in consequence of breach

of trust or breach of duty may be taken against *de facto* directors and officers although their appointment may have been irregular (*Coventry and Dixon's Case,* (1880) 14 *Ch. D.* 660; *Re. Western Counties Steam Bakeries Company,* (1897) 1 *Ch.* 617). The resolutions passed by a general meeting called by *de facto* directors are not invalid for reason of the irregularity in the constitution of the board (*Boschoek Proprietary Co. Ltd.* v. *Fuke,* (1906) 1 *Ch.* 148). We have already seen that under Sec. 83B the subscribers of the memorandum of association of a company (other than a private company) are *de facto* directors where default is made in the appointment of directors and subject to any regulations in the articles of the company. It is further laid down by Sec. 83B (2) that *notwithstanding anything contained in the articles of a company other than private company not less than two-thirds of the whole number of directors shall be persons whose period of office is liable to determination at any time by retirement of directors in rotation. This sub-section does not apply to a company incorporated before the commencement of the new act.* This section now makes it compulsory that a certain proportion of the number of members of a board must be those who must retire by rotation and thus materially alters the old position where retirement by rotation was not compulsory unless articles specifically provided for same. Sec. 86 which we have quoted above, not only covers all acts done by *de facto* directors, as far as outsiders are concerned, ignorant of the defect in their appointment, but also as regards acts affecting members in relation to the company *inter se,* such as where calls have been made or shares allotted as we saw above (*Transport Co.* v. *Schonberg,* (1905) 21 *T. L. R.* 305; *Channel Collieries* v. *Dover Railway,* (1914) 2 *Ch.* 506).

Local Directors

A company which carries on business abroad or in different districts of India frequently, finds it convenient

to place the management of its business in each centre or district, under a special local board appointed by it. In order to effectively carry out this object, the articles of association of these companies contain special clauses permitting the board of directors at their head office or central office, to delegate their powers and to appoint and remove and otherwise control the local directors' board. Here powers are given to them to appoint persons to be members of such local board or act as managers or agents and to fix their remuneration. They may even authorise the local board or its members to fill up vacancies therein and to act notwithstanding vacancies.

Further Specimen Form of Articles regarding Local Directors

We have dealt with forms of articles for the appointment of local boards under the heading of "Powers of Directors" by giving their specimen articles from the precedents selected from articles of association in use in India. Mr. Palmer in his book on precedents, Volume 1, suggests the following articles :—

Local Management.

(1) The directors may from time to time provide for the management of the affairs of the company abroad (or any special locality in the United Kingdom) in such manner as they shall think fit, and the provisions contained in the six next following paragraphs shall be without prejudice to the general powers conferred by this paragraph.

Local Board.

(2) The directors from time to time, and at any time, may establish any local board or agencies for managing any of the affairs of the company abroad (or in any specified locality in the United Kingdom), and may appoint any persons to be members of such local boards, or any managers or agents, and may fix their remuneration.

Delegation.

(3) The directors from time to time, and at any time may delegate to any person so appointed any of the powers, authorities, and

discretions for the time being vested the directors, and may authorise the members for the time being of any such local board, or any of them, to fill up any vacancies therein, and to act notwithstanding vacancies, and any such appointment or delegation may be made on such terms and subject to such conditions as the directors may think fit, and the directors may at any time remove any person so appointed and may annul or vary any such delegation.

Powers of Attorney.

(4) The directors may any time, and from time to time, by power of attorney under the seal, appoint any persons to be the attorneys of the company for such purposes and with such powers, authorities and discretions (not exceeding those vested in or exercisable by the directors under these presents), and for such period and subject to such conditions as the directors may from time to time think fit, and any such appointment may (if the directors think fit) be made in favour of the members or any of the members of any local board established as aforesaid, or in favour of any company, or of the members, directors, nominees or managers of any company or firm, or otherwise in favour of any fluctuating body of persons, whether nominated directly or indirectly by the directors, and any such powers of attorney may contain such provisions for the protection or convenience of persons dealing with such attorneys as the directors think fit."

MANAGING DIRECTORS

Frequently directors appoint one of their numbers as a managing director, to look after in detail the management of the company. Here two offices, namely that of the manager and the director, are merged into one person.

Here it will be interesting to note that our Indian Companies (Amendment) Act of 1936 now specifically defines a manager as distinguished from managing agent, which definition must be usefully considered in connection

with the discussion of the position of the managing director because as we have already seen a managing director is a director who is also a manager. The definition of a manager according to Sec. 2 (1) (9) is as follows :—

> *"Manager" means a person who, subject to the control and direction of the directors has the management of the whole affairs of a company, and includes a director or any other person occupying the position of a manager by whatever name called and whether under a contract of service or not;*

In order to appoint such a managing director and to delegate to him such powers of the board as may be deemed necessary, power must be given to the company by special articles as is generally the case (*Nelson* v. *James Nelson & Sons*, (1914) 2 *K. B.* 770). The company in general meeting may also empower the directors to appoint a managing director (*Boschoek Proprietary Co.* v. *Fuke*, (1906) 1 *Ch.* 148). Once the directors are given the power to appoint managing directors, the company cannot interfere with the discretion of the directors in the exercise of these powers (*Logan Ltd.* v. *Davis*, (1911) 104 *L. T.* 914). Where articles already give power of delegation to the board of directors, a stranger dealing *bona fide* with a managing director has a right to take it for granted that the said officer had all the powers he claimed to possess (*Biggerstaff* v. *Rowatt's Wharf*, (1896) 2 *Ch.* 93); but this does not apply to one who did not know of the power of delegation (*Houghton & Co.* v. *Nothard, Lowe & Co.*, (1927) 1 *K. B.* 246).

Where the appointment of the managing director is found to be invalid, the company can recover the money paid to him by way of salary (*Brown* v. *Hays*, (1920) 36 *T. L. R.* 330). If a person who is appointed as a managing director ceases to be a director, he also ceases to hold the office of a managing director, even though there is not an express provision to that effect in the articles (*Bluett* v. *Stuchbury's Ltd.*, (1908) 24 *T. L. R.* 469). It is therefore best to provide in the articles empowering the appointment of managing directors to the

effect that, in case where a person retires by rotation as a director, he shall not cease to hold the office as a manager. Where a managing director has been lawfully appointed, his appointment cannot be revoked, even though the articles contain such power, where there is a contract between the company and him for a fixed period (*Nelson* v. *James Nelson & Sons,* (1914) 2 *K. B.* 770). Where however, such a contract does not exist for a term, with the managing director he can be removed, even though there is no express power to revoke the appointment in the articles (*Foster* v. *Foster,* (1916) 1 *Ch.* 532). Even where the managing directors are appointed and are delegated the powers of management, it is usual for the board of directors to reserve to themselves certain important acts such as borrowing money, taking security, etc. Thus it is frequently the case that the powers of the managing director are also, specifically, stated in the articles for preference. Where an appointment of a managing director is made without stipulating the time for which the appointment is to subsist, the same may be determined at any time and it cannot be argued that the said managing director was entitled by implication to hold the office so long as he was a director (*Foster* v. *Foster,* (1916) 1 *Ch.* 532). Of course the managing director as the agent of the company is in a fiduciary position and cannot accept commission or bribes or shares of profits from persons dealing with the company, as in that case he is liable to be dismissed without notice and called upon to pay over to the company any amount so wrongfully received just on the same footing as an agent would be (*Parker* v. *McKenna,* (1874) *L. R.* 10 *Ch.* 96).

The managing director is not a clerk or servant within the meaning of Sec. 230 of the Indian Companies Act and thus he shall not be entitled to prove for his salary or remuneration as a preferential creditor in the bankruptcy of the company (*Newspaper Proprietary Syndicate,* (1900) 2 *Ch.* 349). The exact duty of the

managing director must be distinguished from that of the secretary of the company. The managing director has to look after the business of the company's activity and the secretary to purely company practice which falls under the duties of the secretary of a joint stock company. It is thus held that it is doubtful whether a company is liable for misrepresentations made by the managing director with regard to transfer of shares and affairs of that nature (*George White Church* v. *Cavanagh,* (1902) *A. C.* 117; *Cartmell's Case,* (1874) 9 *Ch.* 961). The directors cannot appoint a managing agent on condition that he is to be free from their supervision (*Horn* v. *Henry Faulder & Co.,* (1908) 99 *L. T.* 524). Where a managing director had a contract of his appointment for four years, and the company went into liquidation in which resolution he himself voted, it was held that that fact did not deprive him of his right to damages for termination of his contract, as his positions as a director and a shareholder were distinct (*Fowler* v. *Commercial Timber Co., Ltd.,* (1930) 2 *K. B.* 1).

We have already seen that Secs. 91C and 91D are of considerable importance in connection with agreements of the company with managers or managing agents or managing directors. These sections would apply to managing directors and lay down that where a company enters into a contract for the appointment of a manager *or managing agent* of the company in which contract any director of the company is directly or indirectly concerned or interested or varies any such existing contract the company shall *within twenty-one days from the date of entering into the contract or the varying of the contract* send an abstract of the terms of such contract or variation as the case may be, together with a memorandum clearly indicating the nature of the interest of the director in such contract or in such variation every member and the contract shall before to inspection of any member at the registered office of the company. In case of default a fine of one thousand rupees is imposed on the company

on every officer who knowingly and wilfully authorises or permits the default. (S. 91C).

In connection with these contracts the defect of the old section was that there was no time-limit fixed within which the abstract of the contracts or their variation was to be sent to the members of the company. The Indian Companies (Amendment) Act of 1936 has now supplied this want by providing that this has to be done " within 21 days from the date of entering into contracts or the varying of the contract."

The other important section in this connection is Sec. 91D of the act where it is provided that every member or other agent of the company other than a private company *not being the subsidiary company of a public company* who enters into a contract for and on behalf of the company in which contract the company is an undisclosed principal, must at the time of entering into the contract make a memorandum in writing of the terms of the contract, and specify therein the person with whom the contract was made.

It has been further provided that every such manager or other agent shall forthwith deliver the memorandum as provided above to the company and *send copies to the directors,* and such memorandum shall be filed in the office of the company and laid before the directors at the next directors' meeting. In case of default the contract is to be void as against the company and the manager or the agent is liable to a fine not exceeding rupees two hundred. This section was originally introduced in the old Indian Companies Act of 1913 with a view to prevent the abuses said to be prevailing in those days which were peculiar to India. In this country firms of merchants and private companies doing independent business in commodities such as cotton, coal, etc., act as managing agents. Here the complaint was that these managing agents when they found that the contracts that they had entered into for the purchase of cotton, coal, etc., had become unfavourable through the fall of the market, passed them on to

the companies under their management under the excuse that these were purchased for the respective companies under their management by them in their capacity of managing agents. The original section only provided that a memorandum of such contracts shall be "delivered and filed in the office of the company and laid before the directors at the next directors' meeting." The result was that the object with which the section was incorporated in the old Act was frustrated in most cases because most of the managing agency companies held meetings of board of directors at very long intervals and in a large number of companies two meetings of board of directors in a year was usual. On strong representations from the Bombay Shareholders' Association the words "and send copies to the directors" were inserted in sub-section (2) with a view to see that the directors are immediately notified of such contracts.

Where a managing director is to be paid a percentage of profit in absence of any agreement, the income-tax is to be considered to be part of the profits of the company and thus the percentage is to be calculated on the profits before the income-tax is deducted (*Measures Bros.* v. *Measures,* (1910) 1 *Ch.* 336; (1910) 2 *Ch.* 248).

Forms of Articles Regarding Managing Directors

The usual forms of articles in connection with managing directors are as follows :—

The directors may from time to time appoint one or more of their body to be managing director or managing directors of the company, either for a fixed term *not exceeding twenty years at a time* and may from time to time remove or dismiss him or them from office and appoint another or others in his or their place or places.

A managing director shall not while he continues to hold that office be subject to retirement by rotation and he shall not be taken into account in determining the rotation of retirement of directors, but he shall, subject to the provisions of any contract between him and the company be subject to the same provisions as to resignation and removal as the other directors of the company, and if he ceases to hold the office of director from any

cause, he shall *ipso facto* and immediately cease to be a managing director.

The remuneration of a managing director shall from time to time be fixed by the directors or by the company in general meeting, and may be by way of salary or commission or participation in profits, or by any or all of these modes.

The directors may from time to time entrust to and confer upon a managing director for the time being such of the powers exercisable under these presents by the directors as they may think fit, and may confer such powers for such time and to be exercised for such subjects and purposes and upon such terms and conditions, and with such restrictions as they think expedient, and they may confer such powers either collaterally with or to the exclusion of and substitution for all or any of the powers of the directors in that behalf, and may from time to time revoke, withdraw, alter or vary all or any of such powers.

The alternative articles are as follows :—

The directors may from time to time appoint one or more of their body to the office of managing director or manager for such term as they think fit, and a director so appointed shall not while holding that office be subject to retirement by rotation or taken into account in determining the rotation of retirement of directors, but, his appointment shall be subject to determination *ipso facto* if he ceases from any cause to be a director, or if the company in general meeting resolve by extraordinary resolution that his tenure of the office of managing director or manager be determined.

The first managing directors of the company shall be the said H. E. and J. S. and they and the said T. O. M. and W. shall also be the first managers of the company, and the said five persons shall be appointed to the said offices and hold same on the terms of the five draft agreements with them respectively, which have already been prepared and subscribed for identification by Mr. X, solicitor.

A managing director or manager shall receive such remuneration (whether by way of salary, commission, or participation in profits, or partly in one way and partly in another) as the directors may determine, and a director holding office as both managing director and departmental or other manager may receive remuneration in respect of each office : Provided that the remuneration of a director for his services as manager shall not without the approval of the company in general meeting, exceed £ 1,090 per annum.

The directors may entrust to and confer upon a managing

director or manager any of the powers exercisable upon such terms and conditions and with such restrictions as they think fit, and either collaterally with or to be the exclusion of their own powers.

Another alternative form of articles is as follows :—

The directors may from time to time appoint a managing director or directors or managing agents for a fixed term not exceeding twenty years at a time and may from time to time, but subject always to the provisions of any contract between him or them and the company, remove or dismiss him or them from office and appoint another or others in their place. In the event of the directors appointing managing agents, such managing agents are hereby expressly empowered from time to time for the purpose of representing them as such managing agents in all manner of things pertaining to their office and appointment to nominate a person or persons who shall exercise and perform (and in the event of there being more than one, then either jointly or severally) all powers and duties devolving from time to time upon the managing agents to the intent that the acts, omissions and defaults of such person or persons shall be deemed to be the acts omissions and defaults of the managing agents. Such person or persons so appointed by the managing agents, shall be *ipso facto* a director or directors and shall style himself or themselves managing director or managing directors and shall be required to hold or acquire and hold qualification shares.

A managing director whether appointed by the directors or by the managing agents shall not, while he continues to hold that office, be subject to retirement by rotation and he shall not be taken into account in determining the rotation of retirement of directors or the number of directors to retire.

The remuneration of a managing director (other than a managing director appointed by the managing agents) and the remuneration of the managing agents shall from time to time be fixed by the directors and may be by way of fixed salary, or commission or dividends or profits or turnover of the company or of any other company in which the company is interested or by participation in any such profits, or by all or any of these modes. A managing director appointed by the managing agents shall not be entitled to any remuneration from the company but shall be entitled to directors' fees.

The directors may, from time to time, entrust to and confer upon a managing director or the managing agents for the time being, either by resolution or by agreement, such other powers exercisable under these presents by the directors as they may

think fit and may confer such powers for such time, and to be exercised for such objects and purposes, and upon such terms and conditions, and with such restrictions as they may think fit; and they may confer such powers either collaterally with or to the exclusion of, or in substitution for all or any of the powers of the directors in that behalf; and may from time to time but subject to any such agreement revoke, withdraw, alter or vary any such power.

MANAGING AGENTS

In India we have a peculiar system in operation in connection with the management of our companies under which a firm of merchants or a private limited company is appointed a manager or managing agent of a number of companies. In most cases the managing agents are themselves promoters of the companies and as such take a leading part in the settlement of various questions of preliminary contracts with the company they are promoting as founders and of which they propose ultimately to become managers in the garb of managing agents. In spite of the fact that managing agency system has existed in India for more than half a century, the Indian Companies Act not only failed to define a managing agent but even failed to mention the expression "managing agent" anywhere within the fold of its 290 sections. This anomaly has now been removed by the Indian Companies (Amendment) Act of 1936 and not only now managing agents are defined by the act in a series of sections *viz.*, Secs. 87A to 87I, but the various incidents applicable to managing agency work and organisation have been provided for in the light of past experience of the working of the system. The idea dominant in the mind of the legislator has naturally been to see that without in any way restricting the expansion and growth of company organisation on which our Indian industries largely depend, they should bring the managing agency organisation within the control both of the shareholders as well as the law in a way as would tend to increase the confidence of the investors on the one hand and on the other hand protect an honest and first class

managing agent from unequal competition of adventurers appearing on the market with fantastic schemes of more or less mushroom growth.

Thus the act now defines the managing agents in Sec. 2 (9A) as follows :—

"Managing agents" means a person, firm or company entitled to the management of the whole affairs of a company by virtue of an agreement with the company and under the control and direction of the directors except to the extent, if any, otherwise provided for in the agreement, and includes any person, firm or company occupying such position by whatever name called :

Explanation :—If a person occupying the position of a managing agent calls himself a manager he shall nevertheless be regarded as managing agent and not as manager for the purposes of this Act.

It will be seen from the above definition that a very able attempt has been made to bring within the purview of the definition not only the explanation of what the system happens to be but also to prevent persons assuming other garbs or names though they may be actually *de facto* acting as managing agents and thereby escaping the provisions of the act. The definition was drafted after considerable difficulty and it is to be seen how far it works satisfactorily in practice. It is however in the opinion of the author a very bold attempt to tackle a rather difficult and complicated problem.

Terms of Period of Managing Agency Agreement

The greatest opposition offered to the managing agency agreements from the stand-point of the investors by the Bombay Shareholders' Association was the length of the term of managing agency contracts. A term of fifty years was not uncommon and in many cases it was provided in addition that after the expiry of the said term the agents could continue until they resigned and the agency contract itself was expressed to have been entered into between the company and the agents, their heirs, successors and assigns. It has been now laid down in this connection that :—

"No managing agent shall after the commencement of the Indian Companies (Amendment) Act, 1936 be appointed to hold the office for a term of more than 20 years at a time. However, with regard to those who were appointed prior to the commencement of the Act it is laid down that notwithstanding anything to the contrary contained in the articles of a company or in any agreement with the company, a managing agent of a company appointed before the commencement of the Indian Companies (Amendment) Act, 1936 shall not continue to hold office after the expiry of 20 years from the commencement of the said Act unless then reappointed thereto or unless he has been reappointed thereto before the expiry of the said 20 years. In case of old managing agents it is further provided that upon such termination such managing agents shall be entitled to a charge upon the assets of the company by way of indemnity for all liabilities or obligations properly incurred by the managing agents on behalf of the company subject to existing charges and encumbrances if any and that the termination of the office of the managing agent by virtue of these provisions shall not take effect until all moneys payable to the managing agents for loans made to or remuneration due up to the date of such termination from the company are paid. This section is not to apply to a private company which is not the subsidiary company of the public company." (Sec. 87A).

It will be seen from this that the rights of the old managing agents appointed prior to the act have been preserved for a further period of 20 years after the commencement of the Act in case their agreements are lengthy enough to exceed this period. The other protection given to them is that in case they have advanced any money or incurred any personal liability on behalf of the company, they would naturally have a right to be indemnified for same and that the termination of their office is not to take effect until all moneys payable to them for loans made to the company or any remunerations due up-to-date are paid.

Conditions Applicable to Managing Agents

It is further laid down that :—

It is further laid down that *"notwithstanding anything to the contrary contained in the articles of a company or in any agreement with the company, a company may by a resolution passed at a*

general meeting of which notice has been given to the managing agent in the usual manner as to members of the company, remove a managing agent, in case he is convicted of an offence in relation to the affairs of the company punishable under the Indian Penal Code and being under the provisions of the Code of Criminal Procedure, 1898 non-bailable. For the purpose of this clause where a managing agent is a firm or a company, an offence committed by a member of such a firm or a director or an officer holding the general power of attorney from such firm is to be deemed to be an offence committed by such firm or company. However it is provided that in such cases the managing agent shall not be liable to be removed in case the offending member, director or officer as aforesaid is expelled or dismissed by the managing agent within 30 days from the date of his conviction or if his conviction is set aside on appeal. [Sec. 87B(a)].

Insolvency or Transfer of Office by Managing Agents

In case of insolvency, the office of a managing agent shall be vacated [Sec. 87B(b)], and it is further laid down that a transfer of his office by a managing agent shall be void unless it is approved by the company in a general meeting. [Sec. 87B(c)]. Thus it is not now possible for a managing agent to asign or transfer his office without consulting the company or the shareholders in general meeting. It is however provided that in case where a managing agent's firm changes partners, that shall not be deemed to operate as a transfer of the office so long as one of the original partners shall continue to be a partner of the managing agent's firm. The original partners for this purpose means in case of managing agents appointed before the commencement of the Indian Companies (Amendment) Act, 1936, partners who were partners at the date of the commencement of the said Act, and in case of managing agents appointed after the commencement of the said Act partners who were partners at the date of appointment. (Sec. 87B).

Now under the new act *a charge or assignment of remuneration or any part thereof effected by a managing agent will be void as against the company [Sec. 87B (d)]*.

Compensation

It is usual for managing agents to provide in their agreements with the company for a compensation to be paid to them in case their term of office is cut short through the

company going into liquidation. It was admittedly undesirable that in case the liquidation was brought about through the negligence or default of the managing agent himself that he should still be entitled to sue for and recover anything by way of compensation and thus now the new act provides that :—

If a company is wound up either by the Court or voluntarily, any contract of management made with a managing agent shall be thereupon terminated without prejudice however to the right of the managing agent to recover any moneys recoverable by the managing agent from the company, provided that where the Court finds that the winding up is due to the negligence or default of the managing agent himself, the managing agent shall not be entitled to receive any compensation for the premature termination of his contract of management [*Sec. 87B* (*e*)].

Appointment of Managing Agents

It is now laid down *that the appointment of a managing agent, the removal of a managing agent and any variation of managing agents' contract of management made after the commencement of the Indian Companies (Amendment) Act, 1936, shall not be valid unless approved by the company by a resolution at a general meeting of the company notwithstanding anything contained in Sec. 86E. It is however provided that nothing contained in this sub-section shall apply to the appointment of the company's first managing agent made prior to the issue of the prospectus or statement in lieu of the prospectus where terms of appointment of such managing agent are set forth* [*Sec. 87B*(*f*)].

Remuneration of Managing Agents

In connection with the remuneration chargeable by managing agents who are appointed after the commencement of the Indian Companies (Amendment) Act of 1936, it is laid down that :—

" *That this remuneration shall be a sum based on a fixed percentage on net annual profits of the company, with provision for a minimum payment in the case of absence of or inadequacy of profits, together with an office allowance to be defined in the agreement of management* [*Sec. 87C* (*1*)]. *In case there is any stipulation for remuneration additional to or in any other form than the remuneration specified above, it shall not be binding on the company unless sanctioned by a special resolution of the*

company [*Sec.* 87C (2)]. *Thus now all agreements with the company by managing agents for remuneration in form other than a percentage on profits, etc., such as a percentage on sale, etc., will be void unless they are sanctioned by a special resolution of the company concerned.*

The next point to be noted is that "net profits" on which the remuneration of managing agents is to be calculated are specifically defined by the Act instead of leaving them to be defined in the managing agency agreements according to the whims of the agents concerned. It is now laid down that 'net profits' for this purpose means :—

The profits of the company calculated after allowing for all the usual working charges, interest on loans and advances, repairs and outgoings, depreciation, bounties or subsidies received from Government or from a public body, profits by way of premium on shares sold, profits on sale proceeds of forfeited shares, or profits from the sale of the whole or part of the undertaking of the company but without any deduction in respect of income-tax or super-tax, or any other tax or duty on income or revenue or for expenditure by way of interest on debentures or otherwise on capital account or on account of any sum which may be set aside in each year out of the profits for reserve or any other special fund [*Sec.* 87C (3)].

The above section does not apply to a private company except the private company which is the subsidiary company to a public company or to any company whose principal business is the business of insurance [*Sec.* 87C (4)].

Loans to Managing Agents

Under the old act the managing agents could borrow money and did borrow in a large way which resulted in the failure of many concerns due to losses suffered by the said agents in their own personal private businesses. The Amending Act of 1936 has now enacted that :—

"No company shall make to a managing agent of the company or to any partner of a firm of managing agents, or to any director of the private company if the managing agent is a private company any loan out of the moneys of the company or guarantee or loan made to a managing agent [*Sec.* 87D(1)]. *This of course does not*

prevent and is not applicable to any credit held by a managing agent in a current account maintained subject to limits previously approved by the board of directors of the company with the managing agent for the purposes of the company's business [*Sec. 87D (2)*]. *If this rule is contravened in any way, any director of the company who was a party to the making of the loan or giving of the guarantee shall be punishable with fine which may extend to rupees five hundred and if default is made in repayment of the loan or discharging the guarantee the said director shall be liable jointly and severally for the amount unpaid* [*Sec. 87D(3)*].

This section does not apply to a private company except the private company which is the subsidiary of a public company.

Contracts by Managing Agents for Purchase and Supply of Goods to Companies

In this connection it is laid down that :—

"*Except with the consent of the three-fourths of the directors present and entitled to vote on the resolution, a managing agent of the company, or the firm of which he is a partner, or any partner of such firm, or if the managing agent is a private company, a member or director thereof, shall not enter into any contract for the sale, purchase and supply of goods and materials with the company. The rule of course does not apply to or affect any contract for such sale, purchase or supply entered into before the commencement of the Indian Companies (Amendment) Act of 1936* [*Sec. 87D (5)*].

Inter-Company Loans and Purchase of Shares

A practice had grown up by which it was universally common for companies under the same managing agents to lend and borrow from one another large amounts of money. It was discovered that in good many cases a sinking company was propped up by managing agents with a view to maintain their own remuneration for the management, through making some other prosperous company under their management advance money to this sinking concern. In some cases this money was advanced through the purchase of debentures issued by the company in a less favourable position, as an investment on reserve fund

by the stronger company, and in other cases, a still more undesirable practice of borrowing on fixed deposits on the credit of the substantial company under the management, with a view to lend that amount to a weaker company which had no such credit was indulged in. This naturally resulted in the weakening and in many cases the ruination of many good companies through the failure of the weaker borrowing companies.

The new Indian Companies (Amendment) Act of 1936 now provides that :—

"No company incorporated under the Act after the commencement of the Amending Act of 1936 which is under the management of a managing agent shall make any loan to or guarantee any loan made to any company under management of the same managing agent and no company shall after the expiry of six months from the commencement of the said Act except by way of renewal of an existing loan or guarantee given make any loan to or guarantee any loan made to any such company. This rule is not to apply to loans made or guarantees given by a company to or on behalf of a company under its own management or loans made by or to a company to a subsidiary company thereof or the guarantee given by a company on behalf of a subsidiary company thereby [Sec. 87E (1)]. Any contravention of this provisions would entail a fine not exceeding rupees one thousand on any director or officer of the company making the loan or giving the guarantee who is knowingly and wilfully in default and he shall be also jointly and severally liable for any loan incurred by the company in respect of such loans or guarantee" [Sec. 87E(2)].

In connection with the purchase of shares it is laid down that :—

A company other than an investment company, that is to say, a company whose principal business is the acquisition and holding of shares, stocks, debentures of other securities, shall not purchase shares or debentures of any company under management by the same managing agent, unless the purchase has been previously approved by a unanimous decision of the board of directors of the purchasing company (Sec. 87F).

Managing Agents' Powers to Issue Debentures

It is now laid down that :—

"The managing agent shall not exercise in respect of any company of which he is a managing agent the power to issue

debentures or except with the authority of the directors, and within the limits fixed by them, a power to invest the funds of the company and any delegation of such power by a company to a managing agent is void (Sec. 87G).

Managing Agents' Competing Business and Nominee Directors

In this connection it is laid down by the new Amendment Act that :—

" The managing agent shall not on his own account engage in any business which is of the same nature as and directly competes with the business carried on by a company under his management or by a subsidiary company of such company (Sec. 87H).

With regard to the limits of the powers to appoint nominee *ex-officio* directors, it is now laid down that :—

" Notwithstanding anything contained in the articles of a company other than a private company, the directors, if any, appointed by the managing agent, shall not exceed in number one-third of the whole number of directors (Sec. 87I)."

Managing Agency Agreements

The managing agency agreements have thus to be drafted bearing in mind the aforesaid restrictions and reservations of the Indian Companies (Amendment) Act of 1936. The actual clauses of agreements as they appear in the agency agreements will be found in Vol. II and on reference to the Index. The agency agreement besides stating the term of agency and the remuneration of agents contains clauses stating specifically the various powers which the agents are to exercise under the supervision of the board of directors. The clauses after specifying these various powers add a general proviso to the effect that " generally to make all such arrangements and do all such acts and things on behalf of the said company, its successors and assigns as may be necessary or expedient and as are not specifically reserved to be done by the directors." The articles of association also

embrace special clauses dealing with the powers of the managing agents both specifically and generally, which are more or less in conformity with agency agreement clauses. Besides this, the agency agreement is mentioned in the "objects clause" of the memorandum of association of the company concerned and is also referred to in its articles of association to which frequently it is appended. We have already seen a model clause of the memorandum of this type and deal hereafter with other clauses, both of the memorandum and articles relating to the agency management. Besides the usual powers of management and remuneration the agency agreements also provide for the appointment of *ex-officio* directors on the board of directors who are to be nominated by the agents from among the partners of the agency firm which fact is also reiterated in the articles of association. *We have seen that directors if any, appointed by the managing agents shall not exceed in number one-third of the whole number of directors (Sec. 87I).* A special clause in old agency contracts used to empower the agents to assign the whole or any portion of their earnings to anybody they please, without thereby in any way affecting their appointment as such agents and power was also given to every member of agency firm to assign the whole or any portion of his own share of earning. Now under Sec. 85B of the Amending Act of 1936 *a transfer of the office of the managing agent is void unless approved by the company in general meeting and a charge or assignment of his remuneration of any part thereof effected by him is also void as against the company.* Frequently clauses occur in the agents' agreements, by which it is provided that in case a company goes into winding up or liquidation the agency firm should be given a specific compensation. Here it is laid down by the Amending Act of 1936 that *no compensation shall be payable where the Court finds that the winding up is due to the negligent or default of the managing agent himself.* Often a clause is also inserted in the memorandum of association in

which the name of the managing agency firm is stated and in which a provision for their continuance in office for a certain number of years and sometimes even the agency's remuneration is mentioned. Though it is now held that such a clause in the memorandum may not be alterable, yet that clause by itself does not constitute a contract or agreement between the company and the firm which thus constitutes itself as managing agents (*Ahmedabad Jubilee Co.* v. *Chotalal,* (1908) 10 *Bom. L. R.* 141). Even where in such cases there is a separate contract of managing agency the same cannot be specifically enforced, but the remedy would be damages only (*See Nusserwanji* v. *Gordon,* (1882) *I. L. R.* 6 *Bom.* 265). Managing agents like all agents have no lien on the company's papers and property in respect of loans made by them to the company for the purpose of the whole concern, and they are officers of the company under Sec. 2 (11) (*Re. Bombay Saw Mills,* (1889) *I. L. R.* 13 *Bom.* 314). We have already dealt with the rules enunciated in Secs. 91C and 91D in connection with managing directors which would also apply to managing agents. We have seen that the managing agents provide for their remuneration in various forms one of which is by a commission upon the business done or profits earned by the company. This means that this commission has to be paid so long as the company continues to exist as a company. This contract is not necessarily broken simply because the company goes into liquidation, unless it is stipulated that the company shall continue the business or pay compensation in default (*Cowasjee Nanabhoy* v. *Lallbhoy Vullubhoy,* (1876) *L. R.* 3 *Ind. Ap.* 200; *R. S. Newman, Ltd., Raphael's Claim,* (1916) 2 *Ch.* 309; *Reigate* v. *Union Manufacturing Co.,* (1918) 1 *K. B.* 592).

As to the signature of managing agents the same rule applies as in case of all officers of the company, *viz.,* that it should be made clear that they are signing for and on behalf of the company. Thus the signature such as "'X'

& Co., managing agents of Bombay Trading Co. Ltd.," will not bind the company, but a signature as "For The Bombay Trading Co. Ltd., 'X' & Co., managing agents," would be binding. A company cannot be restrained by injunction from removing from their service their managing agents, even where the contract of service provides that the managing agents cannot be removed except under certain specified circumstances as mentioned in the agreement and after the expiry of a specified period. All that the managing agents here can claim for dismissal is damages. It may be noted here that managing agents frequently describe themselves as secretaries, treasurers and agents and act as secretaries in that capacity for more than one company. The question whether notice to them in connection with their work as secretaries of one company is notice also to them as secretaries to the other company for which they are also acting as secretaries has been decided in (*Fenwick, Stobart & Co.,* (1902) 1 *Ch.* 507), where it has been held that as a general proposition it cannot be said that a person who is acting as secretary for two companies necessarily is taken to have notice or knowledge in connection with the other company of all that which it came to know in connection with the first company. In order to make it a notice it must be shown that it was his duty to the first company to communicate his knowledge to the second company.

Forms of Clauses in Managing Agency Agreements

The clauses appointing the agents generally run as follows :—

The said X. Y. and Z. and other person or persons for the time being constituting the said firm of Messrs. X. Y. Z. Sons and Company and their successors in business notwithstanding any change in the constitution or in the name or style of the firm and their assigns (hereinafter unless otherwise designated called "the said Firm") shall be the agents of the said company from . . . for a period of . . . years and thereafter as reappointed by the company in general meeting.

Management

The management clause usually runs as follows :—

Subject to the control and supervision of the directors the said firm shall have the general conduct and management of the business and affairs of the said company and shall have power on behalf of the said company to acquire by purchase, lease or otherwise lands, tenements and other buildings and to erect, maintain, alter and extend factories, warehouses, engine houses and other buildings in Bombay or elsewhere in India; to purchase, pay for, sell, resell and repurchase in India and elsewhere machinery, engines, plant, raw cotton, jute, wool and other fibres and product, stores and other materials and to manufacture yarn, cloth and other fabrics and to sell the same either in Bombay or elsewhere and either on credit or for cash, and for present or future delivery; to execute become parties to, and where necessary to cause to be registered all deeds, agreements, contracts, receipts and other documents; to insure the property of the said company for such purposes and to such extent and in such manner as they may think proper; to institute, conduct, defend, compromise, refer to arbitration and abandon legal and other proceedings, claims and disputes in which the said company is concerned, to appoint and employ, discharge, re-employ or replace engineers, managers, retail commission dealers, muccadams, brokers, clerks, mechanics, retail men, and other officers and servants with such powers and duties and upon such terms as to duration of office remuneration or otherwise as they may think fit; to draw, accept, endorse, negotiate and sell bills of exchange and hundis with or without security and to receive and give receipts for all moneys payable or to be received by the company and to draw cheques against the moneys of the said company, and generally to make all such arrangements and do all such acts and things on behalf of the said company its successors and assigns as may be necessary or expedient and as are not specifically reserved to be done by the directors.

An alternative clause in connection with a mining company is as follows :—

Subject to the control of the directors the said firm shall have the general conduct and management of the business and affairs of the said company and in particular shall have power on behalf of the said company to carry on and work the mines and mining rights of the said company and to take oversearch for prospect examine and explore any other mines lands or ground containing or supposed to contain minerals or mineral products

and to search for and obtain information with regard to mines mining claims, mining districts and localities and to despatch and employ expeditions expert, and other agents for the purpose and to do the business of explore prospectors or concessionaires and to buy, take on lease or otherwise acquire, hold, sell, exchange, work, exercise, develop, turn to account and dispose of any land, buildings, machinery, mines, mining or other mineral rights and to finance and carry on any business concern of undertaking so acquired and to search for win work get calcine reduce amalgamate dress refine and prepare for the market any quartz or ore and mineral substances and generally to buy, sell, manufacture and deal in manganese ore minerals and mineral products, plant and machinery and other things capable of being used in connection with mining or metallurgical operations and to lay out land for building purposes and to construct, carry out, maintain, improve and work roads, ways, tramways, railways, bridges, reservoirs, canals, water-courses, vaiducts, hydraulic works, chemical works, stamps, factories, warehouses and other works of the said company and to enter into arrangements with any Government or Authorities, supreme, municipal, local or otherwise and to obtain from any such Government or Authority all rights, concessions, licenses, lease and privileges and to institute conduct, defend, compromise, refer to arbitration and abandon legal and other proceedings and claims by and against the said company and the directors and officers of the said company and otherwise concerning the affairs of the said company and to purchase, provide, maintain and keep up such machinery, implements or stock whether stationery or otherwise and all other things necessary for the said company as the said firm may think proper and from time to time to sell or dispose of the same or any part thereof and to execute become parties to and where necessary to cause to be registered all deeds, agreements, contracts, receipts and other documents and to insure the property of the said company for such purposes and to such extent and in such manner as the said firm may think proper and to give effectual receipts and discharges on behalf of and against the said company for any moneys funds, goods or property lent to or payable or belonging to the said company and to draw receipt, endorse, negotiate and sell bills of exchange and hundis with or without security and to draw cheques against the moneys of the said company and to endorse and transfer Government Promissory Notes or other securities issued by the Government of India and standing in the name of the said company or any bonds of any public authority and to collect and give receipts for the dividends or interest from time to time due to or become due on any such securities and to appoint and employ in or for

the purposes of the transaction and management of the affairs and business of the said company or otherwise for the purposes thereof and from time to time to remove or suspend such solicitors, bankers, managers, experts, engineers, clerks, brokers and any other persons as they shall think proper with such powers and duties and upon such terms as to duration of office, remuneration or otherwise as the said firm shall think fit and to delegate all or any of the powers, authorities and discretions for the time being vested in the said firm and also from time to time to provide by the appointment of an attorney or attorneys, manager or managers for the management and transaction of the affairs of the said company in any specified locality in such manner as they may think fit and generally to make all such arrangements and do all acts and things on behalf of the said company, its successors and assigns as may be necessary or expedient.

Ex-officio Director Clause

The said firm shall be entitled to have three nominees on the directorate of the said company. Each of the said nominees and their successors in office appointed under this clause shall be called an *ex-officio* director. An *ex-officio* director shall be entitled to hold office until requested to retire by the said firm and accordingly he shall not be bound to retire by rotation or be subject to clauses..............of the said company's articles of association. As and whenever *ex-officio* director vacates office, whether upon request as aforesaid or by death or otherwise, the said firm may appoint another director in his place. An *ex-officio* director shall not require any qualification. An *ex-officio* director may at any time by notice in writing to the said company resign his office.

An alternative clause runs as follows :—

The said firm shall be entitled to have two nominees on the directorate of the said company. The said nominees and their respective successors in office appointed under this clause shall be entitled to hold office until requested to retire by the said firm and accordingly they shall not be bound to retire by rotation or be subject to clauses.................of the company's articles of association. As and whenever a director so nominated vacates office whether upon request as aforesaid or by death or otherwise, the said firm may appoint another director in his place, Such directors shall not require any qualification, and may at any time by notice in writing to the said company resign their office.

Clause Giving Power to Assign Agency

It shall be lawful for the said firm to assign this agreement and the rights of the said firm hereunder *with the previous approval of the company in general meeting* to any person, firm or company having authority by its constitution to become bound by the obligations undertaken by the said firm hereunder and upon such assignment being made and notified to the said company the said company shall be bound to recognise the person or firm or company aforesaid as the agents of the said company in like manner as if the name of such person, firm or company had appeared in these presents in lieu of the names of the partners in the said firm and as if such person, firm or company shall forthwith upon demand by the said firm enter into an agreement with the person, firm or company aforesaid appointing such person, firm or company the agents of the said company for the then residue of the term outstanding under this agreement with the like powers and authorities remuneration and emoluments and subject to the like terms and conditions as are herein contained.

It shall be lawful for the said firm to assign the whole or any portion of their earnings as aforesaid without thereby in any way affecting their appointment as such agents as aforesaid.

It shall be lawful for any member of the said firm to assign the whole or any portion of his share of the earnings of the said firm without thereby in any way affecting the appointment of the said firm as such agents as aforesaid.

Clause Stipulating that in the event of the Company being wound up for the purpose of being resold the other Company shall take up the Managing Agents

In the event of the said company being wound up at any time for the purposes and with the object of transferring its business to another company, the said company shall make it one of the terms and stipulations of their agreement for the transfer of their property and business to such other company as aforesaid that such other company shall appoint the said firm of whatever member or members it may be composed of at the time such other company takes over the business of the said company and with the like powers and authorities to the said firm and on the said terms and conditions as to remuneration emoluments and otherwise as are herein contained; it is hereby expressly agreed and declared that save and except with such condition and stipulation as one of the terms of the sale and transfer thereof

the said company will not sell and transfer their business to any other company.

Stipulation for Compensation in case a Company goes into Liquidation Voluntarily, Compulsorily, or under Supervision

In the event of the said company being wound up either voluntarily or by and under the directions of the Court or under the supervision of the Court, the said firm shall receive from the said company or the liquidators thereof as compensation for the loss of their employment as such agents as aforesaid a sum of money equal to five times the average annual amount of the commission and remuneration earned by the said firm as such agents as aforesaid during the three years receding the resolution or order (as the case may be) for the winding up of the said company, PROVIDED HOWEVER that this clause shall not appear in the event of the said company being wound up with the object of transferring its business to any other company.

The Arbitration Clause in the Agency Agreement

In the event of any dispute or difference at any time arising between the said company and the said firm in respect of this agreement or the several matters specified here in or with reference to anything arising out of or incidental thereto, such dispute or difference shall be submitted to and be decided by the arbitration of two arbitrators one to be named by each party to the dispute or difference, which arbitrators shall appoint an Umpire before taking upon themselves the burden of the reference, and this agreement shall be deemed to be a submission to the arbitration of two arbitrators within the meaning of the Indian Arbitration Act, 1899, and all the provisions of that Act (except as hereby expressly varied) or of any Act of the Legislature passed in substitution therefor or in modification thereof and for the time being in force shall be deemed to apply to any reference hereunder.

Another Clause for Management of Business

The general management of the business of the company subject to the control and supervision of the directors, shall be in the firm or person or persons who are for the time being the agents of the company. The firm of Messrs. X. Y. Z. and Company, Bombay, and the partners or members for the time being constituting the said firm and their successors in business,

notwithstanding any change in the constitution or in name or style of the firm and their assigns, shall be the agents of the company, for the period and upon the terms, provisions and conditions set out in the agreement, a copy whereof is subjoined hereto by way of Schedule B.

Pending execution of the said agreement and thereafter the agents shall (subject to the general supervision of the board) have the conduct and management of the business and affairs of the company, and shall have power and authority on behalf of the company to make all purchases and sales and to enter into all contracts and to do all other things usual, necessary or desireable in the management of the affairs of the company or in carrying out its objects; and shall have power to appoint and employ, in or for the purposes of the transaction and management of the affairs and business of the company, or otherwise for the purposes thereof, and from time to time to remove or suspend such managers, experts, engineers, clerks and brokers, as they shall think proper, with such powers and duties, and upon such terms as to duration of office, remuneration or otherwise, as they shall think fit, and generally to appoint and employ any persons in the service or for the purpose of the company as they shall think fit, upon such terms and conditions as they shall think proper.

Receipts signed by the agents for any moneys, or goods or property received in the usual course of business of the company, or for any moneys, goods, or property lent to, or payable, or belonging to the company, shall be effectual discharges on behalf of and against the company for the moneys, funds or property which in such receipts shall be acknowledged to be received, and the person paying any such money shall not be bound to see to the application or be answerable for any misapplication thereof. The agents shall also have the power to sign cheques on behalf of the company.

The agents shall be authorised to sub-delegate all or any of the powers, authorities, and discretions for the time being vested in them, and in particular from time to time to provide by the appointment of an attorney or attorneys for the management and transaction of the affairs of the company in any specified locality, in such manner as they may think fit.

An alternative set of Articles runs as follows :—

Messrs. X. Y. Z. & Co., their successors and assigns shall be and they are hereby appointed managing agents of the company for the period and upon the terms, provisions, and conditions set out in the agreement referred to in Article 3 hereof and hereto

annexed and marked "A". Such agreement may be modified in such manner as may be mutually agreed between Messrs. X. Y. Z. & Co. and the directors and the board is hereby authorised to execute such agreement on behalf of the company.

The general management of the company subject to the control and supervision of the directors shall be in the hands of the managing agents. The first managing agents shall be Messrs. X. Y. Z. & Co., who shall have power and authority on behalf of the company subject to such control and supervision *inter alia* to make all purchases and sales and to enter into all contracts and to do all other things usually necessary or desirable in the management of the affairs of the company or in carrying out its objects and shall have power to appoint and employ in or for the purposes of the transaction and management of the affairs and business of the company or otherwise for the purposes thereof and from time to time to remove or suspend such managers, engineers, solicitors, clerks and other employees as they shall think proper with such powers and duties and upon such terms as to duration of employment, remuneration or otherwise as they shall think fit.

The managing agents shall have power to sign cheques on behalf of the company and to operate on all banking accounts of the company and to recover and receive interest and dividends on Government Promissory Loan Notes, War Bonds and securities of all kinds belonging to the company.

The receipts signed by the managing agents for any moneys, goods, or properly received in the usual course of business of the company or for any moneys, goods or property lent to or payable or belonging to the company shall be effectual discharges on behalf of and against the company for the moneys, goods or property which in such receipts shall be acknowledged to be received and the person paying any such money shall not be bound to see or be answerable for any misapplication thereof.

The managing agents shall at all times during their continuance in office as managing agents have the right to delegate all or any of their powers, authorities and discretions for the time being vested in them and in particular they shall have authority from time to time to provide by the appointment of an attorney or attorneys for the management and transaction of the affairs of the company in any locality and in such manner as they may think fit.

Notwithstanding anything in these articles contained the managing agents are expressly allowed generally to work for and contract with the company and especially to do the work of agents of the company as provided by the preceding articles and

by the agreement referred to in Article 3 hereof (agreement with managing agents) and also to do any other work for the company upon such terms and conditions and for such remuneration as may from time to time be agreed upon between them and the directors of the company.

THE DIRECTOR AS SECRETARY

The appointment of a secretary no doubt falls under the usual powers of the directors. In cases where managing agents are not acting as secretaries they sometimes appoint an officer to do the company's secretarial work and even where they are officially designated as secretaries, they have some officer doing the secretarial work on their behalf who is paid by the company. Wherever the company has no managing agents but is worked under a board of directors with a manager, there is a secretary appointed who is a distinct and separate officer doing his own branch of work independently of the manager, particularly so in case of large companies. As we have already seen, the secretary is the agent through whom the clerical work of the company is done and being a mouthpiece of the board he is to carry out the orders of the board. However, where a secretary is contemplated from the very beginning as distinct officer articles provide for him by a separate clause and frequently prescribe that he shall countersign deeds sealed by the company which is a desirable course to adopt. Frequently articles are so provided as to permit directors to act as secretary or as any other officer such as the following :—

"A director may hold any other office under the company in conjunction with the office of director on such terms and remuneration as may be fixed by the board of directors."

Here under such an all-embracing clause a director can act either as a manager, or a secretary or in any other capacity, except that of an auditor, because the Companies Act prevents an auditor holding the position of a director and *vice versa*. In the absence of such a clause a director cannot accept an incompatible office under

the company and if he does so he vacates his directorship (*Milward* v. *Thatcher,* (1787) 2 *T. R.* 81). Of course agreements are separately entered into with the secretary as to his pay and emoluments in cases such as these. The secretary is frequently authorised by the articles or by directors under powers reserved to them, to sign cheques and other documents as well as correspondence on behalf of the company. Of course his very appointment implies the authority to him for signing such correspondence and documents as are essential to be signed by the secretary in connection with the due dsicharge of his duties. A clause is frequently inserted in the articles actually naming the secretary such as the following :—

"The first secretary of the company shall be Mr. Jamshedji Framji of Bombay who shall hold office as such secretary for the period of three years on terms and conditions as may be settled by agreement with him by the directors from time to time."

In one case where the secretary was asked to answer interrogatories it was held that he should answer same not only out of his own knowledge but must make inquiries from directors and other officers as will enable him to make such answers complete (*Bank of Russian Trade Ltd.* v. *British Screen P. Ltd.,* (1930) *W. N.* 130).

Comparison of Clauses in Table A with the alternative Articles of Association as in use by Indian Companies with notes

DIRECTORS

Table A—Art. 68. The number of the directors and the names of the first directors shall be determined in writing by a majority of the subscribers of the memorandum of association.

NOTE :—The above form as suggested by the Table A is never followed in practice in India but the usual practice is to state exactly both the maximum and minimum number of the directors specifically in the articles in more or less the following form :—

"The number of directors shall not be less than four and not more than eight excluding *ex-officio* directors. In some com-

panies it is however added now-a-days to the effect that of whom eighty per cent. shall always be Indians." Table A does not suggest a clause appointing directors by the article. The present universal practice is to appoint the first directors by the articles in more or less the following form :—

"The persons hereinafter named shall be the first directors, that is to say :—

(1) Sir Rustomji Framji,
(2) Lakshmidas Sundardas, Esq.,
(3) Jagmohandas Ghordhandas, Esq.,
(4) Khan Bahadur Mohd. Abubaker,
(5) Pestonji F. Jinwalla, Esq.,

Frequently an article is introduced providing for the payment of what is called an alternate director in the following form :—

"The director who is or about to go out of *the district of Bombay for not less than three months* may with the approval of the board of directors in writing under his hand appoint any duly qualified person to be an alternate director during his absence, and such appointment shall have effect and such appointee, while he holds office as director, shall be entitled to notice of meetings of the directors and to attend and vote thereat accordingly, but he shall forthwith vacate office if and when the appointor returns or vacates office as director or remove the appointee from office by notice in writing under his hand."

NOTE :—See proviso S. 8B of the Amended Act.

The form for the appointment of additional directors by a special power to the directors is also to be found in some articles as follows :—

"The directors shall have power at any time, and from time to time, to appoint any other persons as directors either to fill a casual vacancy or an addition to the board, but so that the total number of directors shall not at any time exceed the maximum fixed as above, and so that no such appointment shall be effective unless two-thirds of the directors concur therein, but any directors so appointed shall hold office until the next following ordinary general meeting of the company and shall then be eligible for re-election."

In case of Indian companies managing agencies are generally appointed to manage the companies and thus the question of *ex-officio* directors comes in who are nominated by the firm of the managing agents. The form in such a case of the articles runs more or less as follows :—

"Bulsara Co., Limited shall be entitled to nominate from time to time two directors of the company so long as Bulsara Co., Limited are the managing agents of the company and such nomi-

nees shall not be subject to retirement by rotation and shall not be counted in determining the rotation of retirement of directors nor shall they be required to have the necessary share qualification. The directors so nominated by the managing agents shall be called "*Ex-Officio*" Directors. Articles 99, 100 and 105 shall not apply to *Ex-Officio* Directors."

NOTE :—In the above article it should be noted that the articles 99, 100 and 105 are mentioned which relate to rotation and retirement of directors and removal of directors by an extraordinary resolution by the company which are not made applicable in the case of *ex-officio* directors nominated by the managing agents. See Sec. 87I of the Amended Act where it is laid down that *notwithstanding anything c ntained in the articles of a company other than a private company the directors, if any, appointed by the managing agent shall not exceed in number one-third of the whole number of directors.* Also see Sec. 83B (2). As to removal of a director see Sec. 86G.

Table A—Art. 69. The remuneration of the directors shall from time to time be determined by the company in general meeting.

NOTE :—The usual practice is to fix the remuneration by the article itself instead of leaving it open as suggested in the above form of the Table A. The form in usual use in our Indian Companies is more or less the following :—

"The remuneration of every director shall be Rs.........for their duties as defined by these regulations. The directors shall also be remunerated for any extra service done by them outside their duties as defined by these regulations. The directors shall also be paid any travelling and other expenses of attending and returning from meetings of the board (including hotel expenses) and any other expenses properly incurred in connection with the business of the company."

Frequently in this clause words are added to the following effect :—

"And the directors shall be paid such further remuneration (if any) as the company in general meeting shall from time to time determine; and such remuneration and further remuneration shall be divided among the directors in such proportion and manner as the directors may from time to time determine, and in default of such determination within one year, equally."

The above form reserves power to the general meeting for

further remuneration to be given as the general meeting may determine in addition to that provided for by the articles.

With reference to the travelling expenses there are however additions made in case of some articles of association more or less in the following terms :—

"The directors may allow and pay to any director, who is not a *bona fide* resident in (state the name of the place here) and who shall come to (name of place), for the purpose of attending a meeting, such as the directors may consider fair compensation for his expenses and loss of time in connection therewith, in addition to his fee for attending such meeting as above specified."

Table A—Art. 70. The qualification of a director shall be the holding of at least one share in the company, and it shall be his duty to comply with the provisions of Sec. 85 of the Indian Companies Act, 1913.

NOTE :—It is usual to provide a number of shares, large or small in the same form as given above as the qualification of directors in the articles of Indian companies.

POWERS AND DUTIES OF DIRECTORS

Table A—Art. 71. The business of the company shall be managed by the directors, who may pay all expenses incurred in getting up and registering the company, and may exercise all such powers of the company as are not by the Indian Companies Act, 1913, or any statutory modification thereof for the time being in force, or by these articles, required to be exercised by the company in general meeting, subject nevertheless to any regulation of these articles, to the provisions of the said Act, and to such regulations being not inconsistent with the aforesaid regulations or provisions as may be prescribed by the company in general meeting, but no regulation made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if that regulation had not been made.

NOTE :—In this case the Indian companies usually follow the above Table A form with slight variations here and there. It may be noted here that the Indian Companies (Amendment) Act of 1936 now by Sec. 17 (2) requires that the above clause 71 of this Table A shall in any event be adopted and if not the articles *shall be deemed contain* this clause or clauses *identical with or to the same effect as this* clause. There is of course no objection to vest in directors further powers, provided they do not trespass on those exclusively reserved by the Act to the company in general meeting, but these are the minimum they should possess. In addition to this frequently the articles

give in detail the powers which the directors are to exercise from time to time any additional or extra article in detail more or less in the following form :—

"Without prejudice to the general powers conferred by Article....and so as not in any way to limit or restrict those powers and without prejudice to the other powers conferred by these presents, it is hereby expressly declared that the directors shall have the following powers provided they are not exclusively vested in the agents by these presents, that is to say, power :—

(*a*) To purchase or otherwise acquire any lands, buildings, machinery, premises, hereditaments, property, effects, assets, rights, credits, royalties, business and good-will of any joint stock company, firm or person carrying on the business of spinning and weaving or any other business which this company is authorised to carry on, in any part of India.

(*b*) To purchase, or take on lease for any term or terms of years, or otherwise acquire any mills or factories or any land or lands, with or without buildings and outhouses thereon, situate in any part of India, at such price or rent, and under and subject to such terms and conditions as the directors may think fit; and in any such purchase, lease or other acquisition to accept such title as the directors may believe or may be advised to be reasonably satisfactory.

(*c*) To let or lease the immoveable property of the company in part or in whole, for such rent, and subject to such conditions as may be thought advisable. To sell such portions of the lands or buildings of the company as may not be required for the purposes of the company. To mortgage the whole or any portion of the property of the company for the purposes of the company.

(*d*) At their discretion to pay for any property, rights, or privileges acquired by, or services rendered to the company either wholly or partially in cash or in shares, bonds, debentures or other securities of the company and any such shares may be issued either as fully paid up or with such amount credited as paid up thereon as may be agreed upon; and any such bonds, debentures, or other securities may be either specifically charged upon all or any part of the property of the company and its uncalled capital or not so charged.

(*e*) To secure the fulfilment of any contracts or engagement entered into by the company, by mortgage or charge of all or any of the property of the company, and its unpaid capital for the time being, or in such other manner as they may think fit.

(*f*) To give to any officer, or other person employed by the company a commission on the profits of any particular business or transaction, or a share in general profits of the company, and such

commission or share of profits shall be treated as part of the working expenses of the company.

(*g*) Before recommending any dividend, to set aside such portion of the profits of the company as they may think fit, to form a fund to provide for such pensions, gratuities or compensation; or to create any provident or benefit fund in such manner as the directors may deem fit.

(*h*) To pay or allow dividends or bonuses from time to time on all shares held by the company, however acquired.

(*i*) Before declaring any dividend, to set aside out of the profits of the company such sums (such sums being not less than those recommended or approved by the agents) as they may think proper, for depreciation or depreciation fund, reserve fund or sinking fund or any special fund to meet contingencies, or to repay debentures or debenture stock, or for special dividends, or for equalising dividends, or for repairing, improving, extending and maintaining any of the property of the company; or for the welfare and education of the employees etc., of the company; or for providing for bad debts and for other purposes, as the directors may, in their absolute discretion, think conducive to the interests of the company, with powers from time to time to transfer moneys standing to the credit of one fund or any part thereof to the credit of any other fund; and to divide the reserve fund into such special fund as the directors may think fit and to employ the assets consisting all or any of the above funds, including the depreciation fund, in the business of the company or in the purchase or repayment of debentures or debenture stock; and that without being bound to keep the same separate from the other assets and without being bound to pay interest on the same. If the assets constituting any of the above funds are employed in the business of the company, the directors may allow or pay to the credit of such funds interest at such rate as the directors may think proper, but not exceeding 9 per cent. per annum.

(*j*) To appoint any person or persons (whether incorporated or not incorporated) to accept and hold in trust for the company; and property belonging to the company, or in which it is interested or for any other purposes; and to execute and do all such deeds and things as may be requisite in relation to any such trust and to provide for the remuneration of such trustees.

(*k*) To accept from any member, so far as may be permissible by law, a surrender of his shares or any part thereof, on such terms and conditions as shall be agreed.

(*l*) To execute in the name and on behalf of the company in favour of any director or other person who may incur, or be about to incur, any personal liability whether as principal of surety for the benefit of the company, such mortgages of the company's

property (present and future) as they think fit; and any such mortgages may contain a power of sale and such other powers, provisions, covenants and agreements as shall be agreed upon.

(*m*) At any time and from time to time, by power of attorney or under the Seal of the Company to appoint any person or persons, to be attorney or attorneys of the company, for such purposes and with such powers, authorities and discretions (not exceeding those vested or exercisable by the directors under these presents) and for such period and subject to such conditions as the directors may from time to time think fit.

(*n*) Notwithstanding anything herein contained, to give usual commission to the branch firms of the agents' firm or firm in which they are interested otherwise, for purchasing cotton, stores and other merchandise and selling yarn cloth, etc., up-country, and bonus or interest in any particular business or transaction of the company or a participation in the profits thereof.

(*o*) To pay the costs, charges and expenses. preliminary and incidental, to the promotion, formation, establishment and registration of the company.

(*p*) To delegate to any or more of them or to an outsider or outsiders any of the powers vested in them.

(*q*) For or in relation to any of the matters aforesaid or otherwise for the purposes of the company to enter into all such negotiations and contracts, and rescind and vary all such contracts, and execute and do all such acts, deeds and things in the name and on behalf of the company. as they may consider expedient.

(*r*) To sanction and authorise all such matters and things as may be necessary, to be done, authorised or sanctioned in and about the business and affairs of the company, in absence of the agents, caused either by resignation or removal or otherwise, and till such other agents be appointed; and in that case to exercise all the powers and rights and perform all the duties and obligations as would be exercised and performed in pursuance of these presents by the agents of the company, if in office.

Table A—Art. 72. The directors may from time to time appoint one or more of their body to the office of managing director or manager for such term, and at such remuneration (whether by way of salary, or commission or participaticn in profits, or partly in one way and partly in another) as they may think fit, and a director so appointed shall not, while holding that office, be subject to retirement by rotation or taken into account in determining the rotation of retirement of directors, but his appointment shall be subject to determination *ipso facto* if he ceases from any cause to be a director, or if the company in general meeting resolves that his tenure of the office of managing director or manager be determined.

NOTE :—The above form contemplates the appointment of managing directors or managers which in case of companies which have no managing agents is usually adopted in India otherwise special managing agency clauses are introduced specifying the powers of such agents and referring to the various agreements entered into with them by the company in connection with their agencies.

Table A—Art. 73. The amount for the time being remaining undischarged of moneys borrowed or raised by the directors for the purpose of the company (otherwise than by the issue of share capital) shall not at any time exceed the issued share capital of the company without the sanction of the company in general meeting.

NOTE :—The above clause is no doubt a desirable clause to be inserted in the articles of association but it is not universal in case of Indian companies. In fact one comes across same rather rarely.

Table A—Art. 74. The directors shall duly comply with the provisions of the Indian Companies Act, 1913, or any statutory modification thereof for the time being in force, and in particular with the provision in regard to the registration of the particulars of mortgages and charges affecting the property of the company or created by it, and to keep a register of the directors, and to sending to the registrar an annual list of members, and a summary of particulars relating thereto and notice of any consolidation or increase of share capital, or conversion of shares into stock, and copies of special resolutions and a copy of the register of directors and notifications of any changes therein.

NOTE :—The above clause also simply reiterates as a reminder the duties of the directors in connection with mortgages and charges which have to be registered under Indian Companies Act, otherwise the mortgage or charge becomes inoperative.

Table A—Art. 75. The directors shall cause minutes to be made in books provided for the purpose :—

(*a*) of all appointments of officers made by the directors;

(*b*) of the names of the directors present at each meeting of the directors and of any committee of the directors;

(*c*) of all resolutions and proceedings at all meetings of the company, and of the directors, and of committees of directors; and every director present at any meeting of directors or committee of directors shall sign his name in a book to be kept for that purpose.

NOTE :—This clause also is a sort of a reminder to the directors about their duties to cause proper minutes to be taken in books dealing with and defining the said minutes. It is generally bodily incorporated in the Articles of Association of our Indian companies. The Table A suggests that every director present at the meeting of board of directors or committee of directors, should sign his name in a book to be kept for this purpose. This requirement is not made compulsory in Indian companies, but instead of that a paragraph is added to the following effect "and any such minutes of any meetings of the directors or of any committee, or of the company, if purporting to be signed by the chairman of such meeting, or by the chairman of the next succeeding meeting, shall be receivable as *prima facie* evidence of the matters stated in such minutes."

THE SEAL

Table A—Art. 76. The seal of the company shall not be affixed to any instrument except by the authority of a resolution of the board of directors, and in the presence of at least two directors and of the secretary or such other person as the directors may appoint for the purpose; and those two directors and secretary or other person as aforesaid shall sign every instrument to which the seal of the company is so affixed in their presence.

NOTE :—The above form is usually adopted bodily in case of our Indian companies. Sometimes the words added are "the directors shall provide a common seal for the purpose of the company and shall have power from time to time to destroy the same and substitute a new Seal in lieu thereof and the directors shall provide for the safe custody of the seal for the time being."

DISQUALIFICATIONS OF DIRECTORS

Table A—Art. 77. The office of director shall be vacated if the director :—

(*a*) *fails to obtain within the time specified in sub-section (1) of Section 84 of the Indian Companies Act, 1913, or at any time thereafter ceases to hold, the share qualification, if any, necessary for his appointment; or*

(*b*) *is found to be of unsound mind by a Court of competent jurisdiction; or*

(*c*) *is adjudged insolvent; or*

(*d*) *fails to pay calls made on him in respect of shares held by him within six months from the date of such calls being made; or*

(e) *without the sanction of the company in general meeting accepts or holds any office of profit under the company other than that of a managing director or manager or a legal or technical advisor or a banker; or*

(f) *absents himself from three consecutive meetings of the directors or from all meetings of the directors for a continuous period of three months, whichever is longer, without leave of absence from the board of directors; or*

(g) *accepts a loan from the company; or*

(h) *is concerned or participates in the profits of any contract with the company; or*

(i) *is punished with imprisonment for a term exceeding six months :*

Provided, however, that no director shall vacate his office by reason of his being a member of any company which has entered into contracts with, or done any work for, the company of which he is director, but a director shall not vote in respect of any such contract or work, and if he does so vote, his vote shall not be counted.

NOTE :—The above clause is bodily adcpted by most of the Indian companies.

ROTATION OF DIRECTORS

Table A—Arts. 78. At the first ordinary meeting of the company the whole of the directors shall retire from office, and at the ordinary meeting in every subsequent year, one-third of the directors for the time being or, if their number is not three or multiple of three, then the number nearest to one-third shall retire from office.

79. The directors to retire every year shall be those who have been longest in office since their last election, but as between persons who became directors on the same day those to retire shall (unless they otherwise agree among themselves) be determined by lot.

80. A retiring director shall be eligible for re-election.

81. The company at the general meeting at which a director retires in manner aforesaid may fill up the vacated office by electing a person thereto.

NOTE :—The above form as given in Articles 78 of Table A is generally follcwed but in case of companies with managing agents, a provision is made to the effect that the director who retires "is not the nominee of the managing agents." This is necessary because retirement by rotation is not

to apply to the nominees of the managing agents who are *ex-officio* and thus more or less permanent directors.

With reference to Article 81 as stated above, the Indian Companies articles usually have additional words with a view to provide that in case new directors are to be proposed at a general meeting in place of those retiring by rotation, their names should be submitted in advance. In such cases the following words would be used "and no director shall be elected unless his name shall be submitted two days prior to the meeting." Some companies also add the words "and that they shall be approved by the directors." It is very doubtful whether the last condition of prior approval by directors would be valid at law.

It may be mentioned here that a further article usually is added to provide for the contingency of vacancies occurring and the minimum number being exceeded to insert the additional article in more or less the following form :—

"The continuing directors may act notwithstanding any vacancy in their body; (but so that if the number falls below the minimum above fixed the directors shall not, except for the purpose of filling vacancies, act so long as the number is below the minimum)."

82. If at any meeting at which an election of directors ought to take place, the places of the vacating directors are not filled up, the meeting shall stand adjourned till the same day in the next week at the same time and place, and, if at the adjourned meeting the places of the vacating directors are not filled up, the vacating directors or such of them as have not had their places filled up shall be deemed to have been re-elected at the adjourned meeting.

NOTE :—The above form is usually adopted by Indian Companies.

SPECIAL NOTE :—Sec. 17(2) provides that articles of companies *shall in any event be deemed to contain clauses identical with or to the same effect as clauses 78 to 81 of Table A.*

Table A— Art. 83. Subject to the provisions of Secs. 83A and 83B of the Indian Companies Act, 1913. The company may from time to time in general meeting increase or reduce the number of directors, and may also determine in what rotation the increased or reduced number is to go out of office.

NOTE :—The above form seeks to empower a general meeting by an ordinary resolution to alter the maximum and minimum number of directors as laid down in the articles. It should however be remembered that Sec. 83A requires that *every company shall have atleast three directors and*

Sec. 83B(2) lays down that notwithstanding anything contained in the articles of a company other than a private company not less than two-thirds of the whole number of directors shall be persons whose period of office is liable to determination at any time by retirement of directors in rotation. This does not apply to a company incorporated before the commencement of the Indian Companies (Amendment) Act of 1936, *where by virtue of the articles of the company the number of directors whose period of office is liable to determination at any time by retirement of directors in rotation falls below the two-thirds proportion mention d in this section.*

Table A—Art. 84. Any casual vacancy occurring on the board of directors may be filled up by the directors, but the person so chosen shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose place he is appointed was last elected a director.

NOTE :—The above form is usually followed by Indian companies. It may be added that articles are also inserted empowering the company in general meeting to remove a director other than the *ex-officio* director because the *ex-officio* directors' appointment depend on a separate agreement with the managing agents.

Table A—Art. 85. The directors shall have power at any time, and from time to time, to appoint a person as an additional director, who shall retire from office at the next following ordinary general meeting, but shall be eligible for election by the company at that meeting as an additional director.

NOTE :—The above article provides for the appointment of an additional director which we have already considered.

Table A—Art. 86. The company may by extraordinary resolution remove any director before the expiration of his period of office, and may by an ordinary resolution appoint another person in his stead; the person so appointed shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose place he is appointed was last elected a director.

NOTE :—The above article is absolutely necessary, and is generally incorporated in the articles of association of Indian companies. Where it is not so inserted, the shareholders would not have the power of removing a director. In Indian forms however the removal is qualified by the

following words "remove any director other than the director *ex-officio*." These words are added because the *ex-officio* directors being nominees of managing agents under a separate agreement are excluded.

PROCEEDINGS OF DIRECTORS

Table A—Art. 90. The directors may elect a chairman of despatch of business, adjourn and otherwise regulate their meetings, as they think fit. Questions arising at any meeting shall be decided by majority of votes. In case of an equality of votes, the chairman shall have a second or casting vote. A director may, and the secretary on the requisition of a director shall, at any time, summon a meeting of directors.

88. The quorum necessary for the transaction of the business of the directors may be fixed by the directors and unless so fixed shall (when the number of directors exceeds three) be three.

NOTE :—The above forms are usual in the case of Indian companies, except that the quorum is usually fixed by the articles of association of Indian companies.

Table A—Art. 89. The continuing directors may act notwithstanding any vacancy in their body, but, if and so long as their number is reduced below the number fixed by or pursuant to the regulations of the company as the necessary quorum of directors, the continuing directors may set for the purpose of increasing the number of directors to that number, or of summoning a general meeting of the company, but no other purpose.

NOTE :—We have already considered this form above.

Table A—Art. 90. The directors may elect a chairman of their meetings and determine the period for which he is to hold office; but if no such chairman is elected, or if at any meeting the chairman is not present within five minutes after the time appointed for holding the same, the directors present may choose one of their number to be chairman of the meeting.

NOTE :—The above form is usual.

With reference to calling of the directors meeting in case of companies under managing agencies, an addition is usually inserted in the following form :—

"The managing agents may at any time and shall upon the request of a director convene a meeting of the director at such place as the managing agents may think fit for the disposal of business. It shall not be necessary to give notice of meeting of the directors to a director who is not in India.

Table A—Art. 91. The directors may delegate any of their powers to committees consisting of such member or members of their body as they think fit; any committee so found shall, in the exercise of the powers so delegated, conform to any regulations that may be imposed on them by the directors.

92. A committee may elect a chairman of their meetings; if no such chairman is elected, or if at any meeting the chairman is not present within five minutes after the time appointed for holding the same, the members present may choose one of their number to be chairman of the meeting.

93. A committee may meet and adjourned as they think proper. Questions rising at any meeting shall be determined by a majority of votes of the members present, and, in case of an equality of votes, the chairman shall have a second or casting vote.

NOTE :—The above forms are usually incorporated bodily in the articles of association of Indian companies with slight variations here and there in the language. Sometimes words added to the above article 91 are "any committee so formed shall in exercise of the powers so delegated conform to any regulations that may from time to time be imposed upon it by the directors." A further article is frequently added as follows :—

"The meetings and proceedings of any such committee when consisting of two or more members, shall be governed by the provisions herein contained for regulating the meeting and proceedings of the directors so far as the same are applicable thereto and are not superseded by any regulations made by the directors under the preceding clause.

Table A—Art. 94. All acts done by any meeting of the directors or of a committee of directors, or by any person acting as a director, shall, notwithstanding that it be afterwards discovered that there was some defect in the appointment of any such directors or persons acting as aforesaid, or that they or any of them were disqualified, be as valid as if every such person had been duly appointed and was qualified to be a director.

NOTE :—The above is a saving clause most necessary in order to avoid the confusion which may be caused through any irregularity practised in the Board meeting innocently and which may be discovered sometime later when the position may have been entirely altered. This form is also usually bodily incorporated in the articles of association of our Indian companies.

Frequently a provision is made for a resolution in writing signed by the directors to be followed as if it were a resolution of a meeting of the board of directors itself. Whatever may have been said as to the desirability of giving such powers, they are valid and binding if the Articles provide for them. The form in which this article runs as follows :—

"A resolution in writing, signed by all the directors shall be as valid and effectual as if it had been passed at a meeting of directors duly called and constituted."

With reference to registration of directors, articles are usually to be found in the articles of association of the Indian companies. They run in more or less the following form :—

"A director may at any time give notice in writing of his wish to resign by delivering such notice to the company, and thereupon his office shall be vacated."

Frequently an Article is also added to the effect that the register of directors should be maintained as provided by Sec. 87 of the Indian Companies Act, 1913. This is one of the Articles which serves to remind the directors as to what they have to do under the Act which runs in the following form :—

"The company is to keep at its office a register containing the names and addresses and occupations of the directors and is to send to the registrar of companies, a copy of such register and shall from time to time notify to the registrar any change that takes place in such directors, as required by Sec. 87 of the Act."

CHAPTER XII

Office Routine and Procedure Re. Directors' Meetings

General Office Work

As the principal executive officer, the secretary, has to carry out the instructions of the board and, for that purpose, has to attend to the correspondence on behalf of the company which he generally signs as the agent of the company. The secretary, for this purpose, should see that the instructions on which he acts are clear and to the point. He has no right to act contrary to his instructions, even though he may think that course to be necessary in the interests of the company. On all important questions he should constantly consult his board or the committee entrusted with the particular department. Even on matters on which he is allowed a discretion it is safe to consult the chairman in case of any doubt or difficulty. With regard to the general office work he has to see that the same is properly distributed among the various departments and that each departmental manager is made responsible for the result. He has to exercise general supervision here as well as to give general directions in the conduct of the work of the company, of course under orders and sanction of the board of directors, or one or other of the executive committees. In small companies he has to manage the whole office establishment, as in such cases the offices of the secretary and the manager are generally merged in one person.

In case of a newly-incorporated company, he has to supervise the filing of the necessary documents and to assist in the conduct of business at the various board meetings held. In case his services are engaged before

incorporation, his appointment will be *sub pro-tem* which is to be duly confirmed after incorporation. He should see the name of the company displayed outside its office premises in prominent letters with the word "Limited" added to it, in case the same is a limited company. On the other hand the newly-appointed secretary to an old established company, in place of a retiring officer, will find his work to be easier with precedents to follow. In the case of a new company his capacity for organization of the office will be fully exercised, whereas, in a going concern he will find a system of organization already at work. All he has to do in the latter case is to follow precedents whenever they appear to be sound and offer suggestions for alteration and improvements wherever necessary. All letters received should, as far as possible, be opened in the secretarial office, either by the secretary or his immediate assistant, and then sorted and distributed to the proper departments for attention. All important letters should be attended to by the secretarial staff itself after obtaining information or explanations necessary from the department or departments interested.

With regard to the accounts department the work here will no doubt rest in the first instance with the accountant of the company, who is a specialist in his branch of work, and all that the secretary can do here is to exercise a sort of general supervision. He should obtain figures from the accountant from time to time with regard to the purchases, sales, and expenses, as well as figures showing the progress or otherwise of profits, bad debts, total financial commitments and resources of the business. These figures are to be placed before the board from time to time in order to keep them in close touch with the results.

Early Company Work and the Secretary

In connection with the early company work of a newly incorporated company, it need only be added that, the various incidents as to preparation of the prospectus,

consideration of the applications, allotment of shares, filing of the various documents and forms, as well as the entries in the various subsidiary books regarding these, as discussed in the previous chapter, are to be attended to by the secretary. He has also to attend to the share transfer work. Here it may be noted that in cases of the death of a member or shareholder, a note should be placed in the register of members as to the death. He should also call for the probate for inspection from the personal representative of the deceased and endorse on it the date of production. The executors or administrators acquire in law the right to transfer or transmit shares, and when transfers are made by them the secretary should satisfy himself as to their legal status. Till that is done the shares should be allowed to stand on the register of members in the name of the deceased member. The company law forbids any notice of trust being entered on the register. The secretary should not therefore enter the name of the executor or trustee as such on the register. If the executor or the trustee gets the shares transferred in his name in his personal capacity as a shareholder, the same may be done, as that course makes the executor or administrator personally liable for the obligations arising from such a holding. In case where shares are held by two or more parties as joint owners, the secretary need only record the notice of death on satisfying himself on that head, as the survivors become the owners of the share on the death of a joint holder. In case a shareholder dies abroad, the secretary should obtain a statutory declaration of death certified by the British Consul of the place where the death occurred. In case of the marriage of a female shareholder a written declaration of marriage duly signed, together with her married name should be obtained and noted on the register of members. In case of the lunacy of a shareholder, where a committee has been appointed the order of the Court should be called for inspection and the fact noted on the register. In case where a joint stock company purchases shares and wishes

to be placed on the register of shareholders, the secretary should ascertain from the memorandum of such a company whether the said company has a right to purchase shares. In case of insolvency of a shareholder, the official assignee in India or the Trustee in Bankruptcy in England, should be called upon to produce the original order of appointment and on inspection a note should be made of it on the register.

Preparation and Work re. Board Meetings

The board meetings of directors may be held as frequently as the directors may in their opinion think necessary and convenient to hold in the interests of the company. The secretary should carefully study the articles of association of his own company and strictly follow the procedure laid down there. Proper notices as to the meetings should be sent to each and every director, and in the case of committee meetings, to every member of the committee. This is very important, as it has been held that failure to send such a notice to a single director entitled to attend at such meeting will invalidate all business that is done or considered on that occasion. In some companies the practice is to fix certain dates, or week days, in advance, on which the board meetings are to be held, whereas in others, the secretary in consultation with the chairman fixes the same. To the notice convening the board meeting, a slip is frequently attached showing the date of the meeting, as well as the name of the director, which the director concerned is requested to hand to the clerk at the entrance of the board room for convenience of recording his attendance, both in the directors' attendance book, and in the board minute book. These notices are made out in the following form :—

THE BOMBAY SPINNING AND WEAVING COMPANY, LTD.

51, Hornby Road,
Bombay, 15th June, 1937.

Dear Sir,

I beg to inform you that a meeting of the Directors of the company will be held at the Registered Offices of the company

on Thursday, the 22nd instant at 5 P.M., (S. T.) when your presence is requested.

Yours faithfully,
J. Fernandez,
Secretary.

To

Sir Solomon Issac, Kt.,
The Reclamation,
Bombay.

The following business is to be transacted :—

(1) General,

(2) Consideration of the Report of Works Committee re. proposed additions.

The Agenda

The secretary should next see that the board room is properly arranged on the date fixed for the meeting and all figures, documents, papers and books, which are likely to be wanted for the purpose of the meeting, are kept on a side-table in proper order. He should prepare the agenda *i.e.*, the list of business to be done at the meeting. The items on the agenda should be arranged in their order of importance, preferably in consultation with the chairman or one of the most active directors. This agenda may be prepared on loose sheets of foolscap paper, a copy of each of which is placed in front of the seat of each of the directors. The chairman's copy, as well as the one retained by the secretary, should have a wide margin on the left with sufficient space left between each item of the agenda. This is done with a view to enable both these functionaries to take careful notes of the proceedings to which it refers in front of the appropriate item on the agenda. The secretary should take care not only to see that his own notes are ample, but that the chairman also takes down full notes of the proceedings. This is done with a view to enable the secretary to produce the chairman's notes when the minutes of the previous meetings come for confirmation in case at the next meeting, any objection or doubt is

raised by one of the directors as to the accuracy of the record as taken down by the secretary. The secretary should preserve both his own as well as the chairman's notes in a separate file after the fair minutes are written out in the minute book.

Form of the Agenda

The form of a board meeting agenda varies according to the nature of the business which has to be placed before the board at each meeting as arising in the regular course of the career of the company concerned. The first and the last item invariably recur in almost every board meeting agenda, except that of the first meeting, *viz.*, " Read minutes of the previous meeting," and " Fixing of the date of the next meeting." The agenda of the first board meeting of a joint stock company will appear in a form similar to the one given below :—

AGENDA

of

Board Meeting, Thursday, 22nd June, 1937, to be held at the Registered Office of the Company.

1. Incorporation of the company, solicitor to report on same.
2. Election of Chairman and Directors.
3. Appointment of officers, *viz.*, the secretary, the manager, managing agents and the accountant.
4. Approval of the draft prospectus and consideration of its issue.
5. Fixing of the date of the next board meeting.

The agenda of a board meeting held right in the midst of the busy life of a successful joint stock company will exhibit items according to the following form :—

AGENDA

of

Board Meeting, Thursday, 22nd June, 1937, to be held at the Registered Office of the Company.

1. Minutes of the last meeting.
2. Bank pass book and cash account as prepared by the accountant to be submitted for approval.
3. Trading returns for the quarter as prepared by the general manager to be submitted.

4. Resignation of Mr. Rodrigues, a director, to be considered.
5. Report of the transfer committee to be submitted for adoption.
6. Correspondence re. J. Dayabhai & Co.'s claim to be submitted for further directions.
7. Date of the next meeting.

The Minutes

At the close of the meeting, or as soon after as possible, the secretary should proceed to draft the "minutes" of the meeting. Great care has to be taken here to see that the draft represents as accurate a record as possible, because when once passed and signed by the chairman of the same or of the next succeeding meeting, the minutes shall constitute evidence of the proceedings. The Indian Companies Act, 1913 (Sec. 83) lays down that "every company shall cause minutes of all proceedings of general meetings and of its directors to be entered in books kept for that purpose." It further enacts that "until the contrary is proved every general meeting of the company, or meeting of directors in respect of the proceedings whereof minutes have been so made shall be deemed to have been duly called and held, and all proceedings had thereat to have been duly had, and all appointments of directors or liquidators shall be deemed to be valid." The language of the section quoted here will impress the reader with the importance of seeing to the accuracy of the record. The law insists on at least one minute book being kept, though in actual practice it is found convenient to keep separate books not only for the board and shareholders' meetings respectively, but in cases where the board is divided into committees, a separate minute book is maintained for each of the committees. The general minute book is open to the inspection of members but the directors' minute book, which records the proceedings dealing with the internal management, is not open to members and is thus provided with a lock and key in the case of many important companies. The minute books should be made of faint ruled foolscap papers, with a

broad margin on the left, and an alphabetical index at the beginning or at the end. Each minute entered in these books is consecutively numbered abbreviated in the margin and indexed. The minutes should be written in the order in which the business was dealt with at the meetings. Minutes are written in various forms, but the one which is the best to be followed is that which includes narration as well as conclusions. To make this clear it may be mentioned that minutes are divided roughly into two classes, *viz.*, (1) minutes of narration and (2) minutes of conclusions. It is the practice with some draftsmen to record only conclusions in the form of the resolutions passed. This is hardly a course to be recommended, even though this form of record may answer the legal requirement. What should be aimed at by a good draftsman is a complete narrative of what actually occurred at a meeting in a brief and compact form, which takes note of all important items of the proceeding without making the same needlessly lengthy or cumbersome. If that is done, no inconvenience or doubt is felt, when, after a number of years, a reference to the record of proceeding at some prior meeting is necessitated. In short a good minute speaks for itself. It does not give rise to confusion. Even an outsider on perusal gets a full and complete idea as to what actually occurred at the meeting in question.

The minutes of each meeting should be kept separate and should commence on a fresh page. They should be headed with the number, date and nature (board or shareholders meeting) of each meeting. The narration should then state in order what actually occurred, which should be concluded with the actual resolution, if any, passed. This resolution should be recorded in full and in the exact wording in which the same was passed. The best course to be followed here is to request the person who proposes a resolution to hand the same over in writing to the chairman. This original writing should, when passed, be copied in the minute book. In case of formal

resolutions passed at board and general meetings, the secretary is frequently requested to draft the same out. Great care, skill and a good knowledge of the principles of company law and practice is required in this branch of secretarial work. In case of resolutions involving intricate questions of law, such as those required to be passed in order to give effect to the alteration, reduction or reorganization or capital, etc., the secretary should call for legal assistance. The minutes in law are evidence, until the contrary is provided, that the meetings to which they refer were duly held and that the proceedings as recorded in them were correct. It will thus be seen that after the minutes are confirmed and signed the secretary has no right to alter them on his own responsibility. We shall now take up a few examples from the agenda of the board meeting given on pages 693, 694 and see how the minutes of the same are recorded.

The Minute Book

The fifteenth meeting of the board of directors was held at the registered office of the company on Thursday, the 22nd of June, 1937, at 4 p.m. (S. T.)

There were present :—

Mr. Dorab Saklat, in the chair,
Rao Saheb T. Rangnekar,
Mr. William,
Mr. Abdul Karim,

DIRECTORS

In attendance :—

Mr. D. Bhabha, Secretary,
Mr. Raghunath Rao, Accountant,
Mr. Dobson, Manager.

65. The minutes of the last meeting held on 2nd June, 1937, were read, approved as correct and signed.

Cash Statements ways and means
66. The secretary produced the Bank Pass Book and a statement showing an abstract of cash receipts and payments during the fortnight ending on the 14th instant. It showed a balance of Bank of Rs. 20,000 and in hand

of Rs. 1,250. The statement was duly checked and formally approved.

Trading Returns. 67. The statement as to the Trading Returns was next submitted which showed a turnover of Rs. 80,000, during the fortnight. This as compared to the turnover of the immediately previous fortnight was in excess by Rs. 5,000, but showed a decline when compared to the corresponding fortnight of the three previous years. The manager explained that this was due to the shortage of available stock as well as of the general rise in prices. The explanation was considered satisfactory and returns were duly approved.

Resignation. 68. The resignation of Mr. Rodrigues, one of the directors, dated 11th May, 1937, was next submitted for consideration. It was suggested by Mr. Rangnekar that Mr. Rodrigues should be requested to reconsider the same. Mr. Dobson stated in reply that he had met Mr. Rodrigues the same morning at the latter's residence with the same object, but Mr. Rodrigues' decision was final, as he was acting on the advice of his physician, who had ordered a complete rest and a change for at least a year.

It was therefore resolved :—that the resignation of Mr. Rodrigues, a director of this company, dated 11th May, 1937, is hereby accepted by the Board with regret and is to take effect from this date. The Board however takes this opportunity to place on record its appreciation of the services of their colleague and wishes him complete recovery.

The secretary was directed to convey this expression of the Board's appreciation to Mr. Rodrigues.

Report of Transfer Committee. 69. The report of the transfer committee, as recorded in that committee's minute book, was next considered. It showed that applications were received for transfer of 50 ordinary shares from five shareholders, all of which, except one from Mr. R. Jonathan, were duly accepted and the transfers given due effect to. It was unanimously resolved that the said report be adopted in full.

Dayabhai & Co.'s Claim. 70. The secretary next produced further correspondence regarding Messrs. Dayabhai & Co., who insisted on claiming the full amount of Rs. 15,000, for the alleged breach of contract for purchase of cotton on our part. The secretary was directed to write finally stating that the said claim was inadmissible.

Next Meeting. 71. The next meeting was fixed to be held at the company's offices on the 5th July, 1937.

Chairman's initials, D. S.

Meetings of Directors

Directors are defined by Sec. 2(5) of the Indian Companies Act of 1913 as including " any person occupying the position of a director by whatever name called ". Another section *viz.*, Sec. 83A makes it compulsory for every public company *to have at least three directors* and Sec. 83B lays down that in default of and subject to any regulations in the articles of the company, other than a private company, the subscribers of the memorandum shall be deemed to be the dirtctors of the company until the first directors shall have been appointed. Thus, if the company has not appointed directors of the company, as is usually done by mentioning them in the articles of association, the subscribers of the memorandum are to act as directors. In such cases the regular directors shall have to be appointed by the members in general meeting. In connection with these appointments it should be remembered that Sec. 83B(2) lays down to the effect that in *a company other than a private* company *not less than two-thirds of the whole number of directors shall be persons whose period of office is liable to determination at any time by a retirement of directors in rotation.* This does not apply to companies incorporated before the commencement of the Indian Companies (Amendment) Act of 1936 *where by virtue of the articles of the company the number of directors whose period of office is liable to determination at any time by retirement of directors in rotation falls below the two-thirds proportion.* The casual vacancies occurring among the directors may be filled up by the

directors, but persons, so appointed, shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose place he is appointed was last appointed a director. It will thus be seen that the company law expects that a board of directors in case of a public company should control and manage the affairs of the company subject, of course, to the powers given to them under the articles of association and also implied by the nature of their appointment.

Summary of Important Points

In connection with the board meetings the following points must be noted :—

1. The directors must act as a board and a single directors as such has no power to bind the company unless given a special delegation under the constitution of the company.
2. Proper notice should be given of the board meeting to all the directors unless the dates of meetings are prearranged and the articles do not specifically provide for notice.
3. The board must act with a quorum and the quorum must be properly constituted.
4. Unless specially authorised by the articles in certain specific case to decide questions by circulars, the directors must meet and decide questions by resolutions.
5. There must be a chairman present at the meeting or one must be appointed.
6. Every director has one vote unless *the articles* otherwise provide.
7. The directors may divide their function and delegate them to committees when so authorised by the articles of association.
8. In connection with the minutes the directors must see that the minutes form a proper record of the meetings they have attended and while confirming or passing the minutes only those who were present at the meeting of which minutes were being considered can vote.

9. The directors have a right to inspect the minute books and may not be prevented from so doing unless where it is proved to the satisfaction of the Court that there are no reasonable grounds for inspection or when they are not acting *bona fide* and in the best interests of the company (*R.* v. *Hampstead B. C.*, (1917) 116 *L. T.* 212).

Directors Must Act as a Board

It is the first principle of company law that the directors can only validly act when assembled at a board meeting unless of course where the articles by special provision permits the directors to pass resolutions by circulars (*D'Arcy* v. *Tamar Hill Railway Co.*, (1867) *L. R.* 2 *Ex.* 158). In connection with the articles of association that authorise the directors to pass resolutions by circulars, it may be noted that the stock exchanges of London and Bombay object to such regulations and refuse to grant a quotation to public companies who take such powers in the articles. The board, while acting, must possess the proper quorum because any business done by a number less than the quorum will have no legal effect. In one case where the articles laid down that the minimum directors' number shall be four and also that the three directors shall be a quorum, it was held that there cannot be a valid quorum which is less than the specified minimum number of directors which should constitute the board (*In Re. Sly Spink & Co.*, (1911) 2 *Ch.* 430). Generally the articles also provide for a certain share qualification in which case the directors appointed must acquire the qualification within the time laid down by the articles or by the Companies Act, whichever is applicable to the case of the company, otherwise their appointments after the expiry of such time shall be vacated. Again where the election of the director himself is invalid the director may provide for his qualification share by joint holding, unless articles provide for a separate holding (*Dunster's Case Re. Glory Paper Mills,* (1894)

3 *Ch.* 478). Even where the director holds shares as an executors that will be good qualification unless the articles provide that the shares shall be held by him "in his own right" (*Grundy* v. *Briggs,* (1910) 1 *Ch.* 444). The directors cannot accept their qualification shares as a present from promoters or vendors (*Hay's Case,* (1875) 10 *Ch.* 593). Under Sec. 85 of the Indian Companies Act if the director does not acquire his qualification within two months, or any shorter time that may be provided for in the articles after his appointment, not only his office will be vacated, as we saw above, but if such an unqualified person acts as a director of the company after the expiry of the said period, he is liable to a fine not exceeding Rs. 50 for every day after the expiration of the said period. However, even though there may be irregularities in the constitution of the board it is held in (*Changamal* v. *Provincial Bank Ltd.,* (1914) *I. L. R.* 36. *All.* 412, that an allotment made by an irregularly constituted board is *prima facie* invalid but that this fact may sometimes be cleared if the articles of association of the company provided for the validation of an act done by a *de facto* director in a *bona fide* manner. In another Indian case, *viz.,* (*Hope Mills Ltd.* v. *Sir Cawasji J. Readymoney,* (1911) 13 *Bom. L. R.* 162), it was laid down that as between the company and the third person having no notice to the contrary the directors *de facto* are directors *de jure.* Even if a director pledges his share by a blank transfer that will not disqualify him (*Pulbrook* v. *Richmond Consolidated Mining Co.,* (1878) 9 *Ch. D.* 610). The director who acts without qualification in breach of the requirement of the Act is also likely to be prevented by an injunction restraining him from acting and is also liable to refund the fee paid to him by the company by mistake while he so acts (*In Re. Bodega,* (1904) 1 *Ch.* 276). The general principle of course is that the outsider is entitled to assume that the domestic affairs of the company are properly conducted (*Royal British Bank* v. *Turquand,* (1856) 6 *E. & B.* 327).

The further requirement is that under Sec. 91B of the Indian Companies Act, 1913 a director cannot vote on any contract or arrangement in which he is either directly or indirectly concerned or interested *nor shall his presence count for the purpose of forming a quorum at the time of any such vote;* and if he does so vote his vote shall not be counted. This of course applies to a public company and not to a board constituted under a private company arrangement. Now as the quorum of a board of directors has to be made up of those who are qualified to vote, the interested directors cannot be counted in the quorum (*Yuill* v. *Greymouth Point E. R. & C. Co.,* (1904) 1 *Ch.* 32). Here if two directors are interested in a particular transaction, the objection that they cannot vote or cannot be counted in the quorum cannot be removed by splitting up the resolution and each director voting on the part affecting the other, nor would it do to reduce the quorum for the purpose of enabling those not interested to pass the resolution (*North Eastern Insurance Co.*, (1919) 1 *Ch.* 198).

We have seen that a single director cannot act, but if regulations authorise, the directors can delegate some one or more of their number, such as the managing director, to exercise some of the powers of the board. The powers, of course, must be express, as otherwise the maxim of agency law *viz., delegatus non potest delegare* meaning that a delegate or an agent cannot delegate his authority to someone else will apply (*Howard's Case,* (1866) 1 *Ch.* 561). The committee may consist of one person or more than one person because it means one or more to whom the powers are committed (*Taurine Co.*, (1884) 25 *Ch. D.* 118).

Notice of Board Meetings

The other point to be clearly noticed is that unless a notice has been given to all the directors a meeting of directors is not considered to be duly convened (*Young* v. *Ladies' Imperial Club,* (1920) 2 *K. B.* 523 *C. A.*). The

secretary is the correct person to convene a meeting of a board of directors but a single director may, in the absence of special regulations, summon a meeting of directors which seems to be the common law rule (*Bhutt* v. *Fellowes*, (1843) 3 *Curt.* 680). If notice is not given and in consequence of that some directors are not able to be present, the proceedings will be invalid (*Harben* v. *Phillips*, (1883) 23 *Ch. D.* 14). It has however been held that there is no duty to send a notice to a director abroad or to one who is travelling about without known address (*Halifax Sugar Refining Co.* v. *Francklyn*, (1890) 62 *L. T.* 564). In another case it was held that where the only two directors of a company meet casually one director cannot treat the meeting as a board meeting against the consent and wishes of the other (*Barron* v. *Potter*, (1914) 1 *Ch.* 895). Directors cannot waive their right to a notice (*Portuguese Consoliadated Copper Co., Steele's Case*, (1889) 42 *Ch. D.* 160). The notice should be so given as to give a reasonable time, but generally this is determined by the custom and practice prevailing in each company if the regulations themselves do not lay down the period (*Browne* v. *La Trinidad*, (1887) 37 *Ch. D.* 1.). If a notice is given as a peremptory notice with the deliberate idea of excluding certain directors, it would be invalid because the Court will always interfere and prevent such wrongful exclusions (*Homer Gold Mines*, (1888) 39 *Ch. D.* 546; *Pulbrook* v. *Richmond Consolidated*, (1878) 9 *Ch. D.* 610). The objection of a notice not being given should be taken as soon as this fact comes to the notice of the director aggrieved. (*Browne* v. *La Trinidad*, (1887) 37 *Ch. D.* 1.). When a notice is given it is usual to state particulars of the business to be done, but it is not compulsory unless the articles require it for the simple reason that directors being a selected body are expected to attend every meeting (*La Compagnie de Mayville* v. *Whitley*, (1896) 1 *Ch.* 788).

There are however occasions where the directors have

fixed certain specific days of the week or month for holding meetings *e.g.*, the first and third Monday of the month. In these cases it is not strictly necessary for the notices to be sent to them, though in actual practice it is usual and desirable to send notices by way of reminders with, if possible, an agenda. At a board meeting it is not necessary for directors to follow the order of the agenda and they can take their business in any order they like (*Crawley & Co.*, (1889) 42 *Ch. D.* 209).

Quorum of a Board of Directors

For joint stock companies it is usual to fix a quorum in the articles. A quorum, of course, means the minimum number competent to transact business and vote without which the resolutions will not be valid (*Greymouth Point E. R. & C. Co.*, (1904) 1 *Ch.* 32). Where the articles have fixed a minimum number of directors a number smaller than that cannot act, unless power is given in the articles to act notwithstanding vacancies (*Alma Spinning Co.*, (1881) 16 *Ch. D.* 681).

Where no quorum is fixed by the articles the directors must act on the footing that all directors must be summoned and majority must be present (*York Tramways Co.* v. *Willows*, (1882) 8 *Q. B. D.* 685). Where the articles provide a quorum that of course must prevail but when such a provision is made but controlling power is vested in governing directors jointly they must all join in exercise of such powers (*Perrott and Perrott Ltd.* v. *Stephenson*, (1934) *Ch.* 171). In one case it was held that where no quorum is specified in the articles the number usually acting will constitute the quorum (*Lyster's Case*, (1867) *L. R.* 4 *Eq.* 233). There is no objection to the articles permitting one director to be a quorum though a single director cannot constitute a meeting (*Re. Fire-proof Doors Ltd.*, (1916) 2 *Ch.* 142; *Sharp* v. *Dawes*, (1876) 2 *Q. B. D.* 26 *C. A.*) and this is the case where there is power to delegate to a committee of one. In another case where though the quorum fixed was three and a seal was

affixed by two on a mortgage deed, it was held that the mortgagee, as the third party having no notice of irregularity, was entitled to treat the deed as valid (*County of Gloucester Bank* v. *Rudry Merthyr & Co.*, (1895) 1 *Ch.* 629). In another case where a board of directors made up of two refused to attend meeting to consider the transfer of shares and it was found that it was done deliberately with a view to prevent such transfers, the Court ordered the company to register the transfer on the ground that the shareholder had a property in the shares which he has the right to dispose of subject only to the express restrictions in the articles (*In Re. Copal Varnish Co.*, (1917) 3 *Ch.* 349). The quorum of course means the minimum number competent to transact business and vote.

The chairman has to see that not only the quorum is present when the work is started, but that it is present all throughout the meeting. A quorum is the minimum number fixed according to the constitution of a company, as represented by its articles of association; or in the absence of any provision in the articles to that effect, the quorum is the majority of directors who are capable of meeting and passing resolutions (*Attorney General* v. *Davy*, (1745) 2 *Atk.* 212). In case of joint stock companies articles usually provide for quorum both in connection with the board of directors' meetings as well as that of the meetings of the company and they must be in that case strictly followed. Otherwise any resolution passed at the meeting would be invalid (*Howbeach Coal Co.* v. *Teague*, (1860) 5 *H. & N.* 151; *in Re. Cambrian Peat Co.*, (1874) 31 *L. T.* 773). It has also been held that the consent of every member of the company separately given will not have the effect of a resolution passed at a meeting (*Re. George Newman & Co.*, (1895) 1 *Ch.* 674), though of course the presence of all the members of the company at a meeting will regularise any resolution passed, even in case there has not been a notice sent to call the meeting or the notice does not contain a statement as to the purpose for which it is called

(*Express Engineering Works,* (1920) 1 *Ch.* 466). In one case of a class meeting of shareholders it was held that where only one person held all the shares of that class, the resolution requiring consent is satisfied by getting same in writing and signed by that one shareholder or member. Thus virtually speaking one shareholder constitutes a meeting in spite of the common law rule which wants at least two to constitute a meeting and a paper signed by that shareholder with a resolution which is required to be passed is considered sufficient (*East* v. *Bennett Bros.,* (1911) 1 *Ch.* 163). In case of directors if no quorum is prescribed by the articles a majority of the board will form a quorum (*York Tramways Co.* v. *Willows,* (1882) 8 *Q. B. D.* 685). It is, however, held in another case that a quorum can be established by the practice of the board (*Regent's Canal Iron Works,* (1867) *W. N.* 79; *Lyster's Case,* (1867) 4 *Eq.,* 233). Frequently articles incorporate a clause to the effect that the continuing directors may act notwithstanding vacancies in which case, even a number less than the minimum number prescribed as quorum can act and bind the company (*Scottish Petroleum Co.,* (1883) 23 *Ch. D.* 413). In one case where, though the articles fixed a minimum number, as well as the maximum number and stated that no less than the minimum number were to act, and at the same time the articles nominated only two directors, it was held that these two cannot act until a complete board of minimum number of directors as required by the articles was formed (*Re. Sly Spink & Co. Re. Hertslet's Case,* (1911) 2 *Ch.* 430). Those directors who are not entitled to vote because they are personally interested in the question of the quorum or for any other reason, cannot be counted in the quorum (*Yuill* v. *Greymouth Point Elizabeth R. & C. Co.,* (1904) 1 *Ch.* 32). It has also been held that if a resolution is specially passed with a view to reducing the quorum, excluding those not interested in the passing, of it will be invalid, (*North Eastern Insurance Co.,* (1919) 1 *Ch.* 198). In the same case it was decided that if two directors are interested in a

transaction which the board is considering, the objection will not be removed if the resolution is split and each director votes only on the part affecting the other.

VOTING BY DIRECTORS

Directors must meet

Looked at from the stand-point of efficient organization, the directors must meet in order to arrive at an accurate decision after hearing all sides of the case, and though L. J. Fry in (*Portuguese Copper Mines,* (1889) 42 *Ch. D.* 160), suggested that, without meeting the directors cannot think, but there is no objection in law if the articles provide that a letter signed by all or a majority of the directors shall have the same effect as the resolution of the board. But, in absence of such an article the directors must meet (*D'Arcy* v. *Tamar Hill Railway Co.,* (1867) *L. R.* 2 *Ex.* 158). Where however the directors are unable or unwilling to meet or perform their duties or exercise their powers for want of quorum or other reasons the general meeting can step in and do that (*Barron* v. *Potter,* (1914) 1 *Ch.* 895; *Foster* v. *Foster,* (1916) 1 *Ch.* 532). In such cases when there is no governing body capable or willing to exercise the function of carrying on the business of the company they can also appoint a receiver and manager (*Featherstone* v. *Cooke,* (1873) 16 *Eq.* 298; *Trade Auxiliary Co.* v. *Vickers,* (1873) *L. R.* 16 *Eq.* 298). In case anything is done at an irregular board meeting but if a regularly constituted board meeting ratifies and conforms same, that will be valid *ab initio* (*Portuguese Consolidated Copper Mines Co.,* (1890) 45 *Ch. D.* 16).

Chairman Necessary

His Election :—The first business of every meeting is to elect a chairman, unless, as in the case of a joint stock company, there is a more or less permanent chairman, nor the vice-chairman is present and the meeting is composed

of persons with equal right to preside, they will have to elect a chairman. This is done by any one present proposing the name of one of the members present, which proposal, if seconded, may be put to vote. If more than one name be proposed and seconded, they may all be put to vote simultaneously and the person securing the largest number of votes takes the chair.

In those joint stock companies, however, where the directors' board is mentioned in the articles of association from the very beginning, the name of the chairman, *i.e.*. the director who is going to occupy the office of chairman, is also mentioned and indicated. In this case it will not be necessary to have either the chairman or the directors elected by a meeting of the shareholders or members of the company. If the chairman is to be elected at a meeting there is nothing to prevent the person whose name is mentioned from voting on that proposition. In case of meetings of creditors the usual practice is for the largest creditor to be voted to the chair. The appointment of a chairman is absolutely necessary in case of every meeting, whether a meeting is held under a joint stock company organization or as a public meeting, or in fact, any other meeting of responsible people where decisions must be arrived at on certain questions that are to be put before the meeting. We have seen that where the chairman is not permanent and is not present and someone has to be selected for the chair because there is no vice-president, either elected or present, the usual practice is to propose in more or less the form "Ladies and Gentlemen—I propose that Mr. Dorabji take the chair." The usual practice is to second this proposition, but there is no common law rule requiring a seconder in this connection (*Harboury Bridge Co.*, (1879) 11 *Ch. D.* 109). In connection with the election of the chairman it is better that one of the scrutineers or the returning officer in case of public election, should not be himself the candidate for the chair (*R.* v. *Owens*, (1858) 28 *L. J. Q. B.* 316). If there is an election of the chairman in more or less an irregular fashion, but

no one raises an objection to the proceeding at the time of election, the tendency of the Courts is to overlook the irregularity (*Longfield Parish Council* v. *Wright*, (1918) 88 *L. J. Ch.* 119). In case the chairman is appointed in contravention of the provisions of the articles of association such an appoint is invalid with the result that a resolution carried through the assistance of a casting vote of such a person is inoperative. This is so even where the board of director acquiesces in same (*Clark* v. *Workman*, (1920) 1 *Ir. R.* 107).

Necessary Qualification

The person selected to act at any meeting as a chairman should be a person possessed of infinite tact. He should be patient, impartial, methodical, logical, firm without being autocratic, good-tempered and preferably one who brings with him special knowledge of the business which is to be disposed of at the meeting. In the words of Mr. Gordon Palin, in his book entitled "Chairman's manual," "A man without any method of habit who cannot, at least on occasions, be judicial and unbiassed whose mental make-up lacks logic; who cannot think and decide pretty quickly; who is not fortified by knowledge of procedure and who cannot express himself well, should not voluntarily take the chair on any occasion, or, if he does, should see that there is a back-exit handy; it may be useful." The same author however adds :—"But there is not one of these shortcomings which may not be largely remedied by assiduous study and practice. Industry and self-training quickly impress the seal of superiority; but he who must avoid this must remain out of the crowd." It will thus be seen that good chairman are generally made and not born. Of course, though there are men—albeit rare—who by the force of personality and the prestige of their general reputation, can keep a large meeting in control even when the most delicate questions are at issue, the general run of chairmen as a class is made up of men who are self-made and who owe their position of eminence to

persevering hard work. The only idea that should supervene in the mind of the chairman all throughout the meeting is to see its business transacted in as orderly and expeditious a manner as possible. In the words of Mr. Albert Crew in his book entitled " Procedure at Meetings," " The chairman should remember that men at the meeting are often but children of a larger (sometimes not much larger) growth, and should combat their petulence, unreasonableness, and pettiness by common sense, sweet reasonableness and quiet determination. He must believe in himself, but not allow his masterfulness to abtrude too much."

For joint stock companies the point to be remembered is that a person who is not a member of the company, cannot be a chairman nor can he be present at the meeting, but of course there is no objection to a chairman remaining in office, as is usually done, until his successor is appointed, whether he is a member or not (*Blair Open Hearth Furnace Co.* v. *Reigart,* (1913) 108 *L. T.* 665; *R.* v. *Jackson,* (1913) 3 *K. B.* 436). It is said that one of the greatest qualification of the chairman is calmness and judicial mien because he has to hold the reins of the whole meeting and feel its pulse carefully so that matters may not get a stage where he cannot control them.

The Duties of the Chairman

The duties of the chairman subject to the regulation in the articles of association, are as follows :—

1. To see that the quorum is present and that the meeting is properly constituted and only those who have a right to be present are there.
2. To see that all legal requirements with regard to calling of the meeting, giving notices, presence of the quorum, etc., are complied with.
3. To see that all the regulations of the company or the body concerned are strictly observed and that the business, as far as possible, continues in the order of the agenda

paper, unless the same is altered with the consent of the meeting.

4. To see that all questions are brought forward before the meeting in proper order in form of resolutions proposed and seconded and amendments also proposed and seconded.

5. To give an opportunity to speak in reasonable terms for a reasonable time to every shareholder or member present who wishes to speak on a proposition before the meeting (*Wall* v. *London & Northern Assets Corporation*, (1898) 2 *Ch. D.* 469; *Parshuram Dattaram & Shamdasani* v. *Tata Industrial, Ltd.*, (1923) 47 *Bom.* 915). He should see that unless a proposition is in the proper manner moved and placed before the meeting no one is allowed to speak, *i.e.*, no discussion should be allowed.

6. To see that the discussion is confined to points relevant to the proposition before the meeting, and that no one uses improper or insulting language.

7. To give his ruling on any point of order that may be raised or where he himself discovers anything irregular or irrelevant being done or said.

8. To see that the proper minutes of the meetings are kept and to sign them.

9. To ascertain the sense of the meeting by putting the question before it after everyone present had said what he wanted to say, or after the question was sufficiently discussed in his opinion and a closure was asked for and passed by the majority, or according to the rules and regulations of the company, if any, bearing on that point. The sense of the meeting is usually ascertained, as we shall see in a later chapter, by show of hands; and in case of joint stock companies if the requisite number of persons present are dissatisfied with the results of the show of hands and demand a poll to grant same. Of course the application for granting the poll has to be made according to regulations of the company or under the common law (*Campbell* v. *Maund*, (1836) 5 *A. & E.* 865).

10. To adjourn the meeting if necessary, according to

the regulations contained in the articles of association of the company, and next to declare the meeting closed.

The Powers of the Chairman

1. The first and foremost is to enforce order, but here if a person has to be ejected after due notice, no more force should be used than is actually necessary.

2. He can speak on any question or move any resolutions himself.

3. Where there is great disorder he has the power to adjourn the meeting. He cannot adjourn at common law if the meeting does not want to adjourn but the articles generally give him the power to adjourn with or without the consent of the meeting.

4. If a poll is demanded he has a right to fix the day, time and place for it.

5. He has a right to vote by giving his casting vote when there is a tie, though there is no common law right by virtue of his appointment to give a casting vote. Of course, in a joint stock company meeting, he has a right to use his votes as a shareholder or member on the resolution in the first instance. The casting vote if given by the articles of association, is his special additional right as a chairman.

6. When the time is limited he can with the permission of the meeting, if he likes, binding each speaker to the occupation of a specific time in connection with his speech.

When opening the meeting it is usual for the chairman to introduce the subject-matter in his opening speech or remarks. In a company meeting the chairman in his opening speech comments on the report and explains by a review of the position during the year for which the report was submitted, at the same time he frequently gives a forecast of what the directors of the company contemplate to do in the near future. In case of public meetings held for a definite object by a special notice, the same process is followed *viz.*, opening the proceeding with an opening

speech of the chairman, but here, of course, the chairman explains the purpose for which they have met and gives his own opinion on the salient points on which he invites discussion and resolutions or motions to be passed or considered by the meeting.

At the annual general meetings of joint stock companies, after the conclusion of the chairman's opening speech on the reports and accounts the chairman invites those present to ask questions or speak on any question relating to the accounts or the report of directors which is before the meeting for adoption. Neither the chairman nor the directors are bound to answer all questions or give information, particularly where they consider it undesirable in the interests of the company to divulge any particular information. The report and accounts are generally put to the vote. If they are not carried that amounts to a vote of censure on the board of directors. This vote of censure does not of course force the directors to retire or resign; but the shareholders may, if they are in sufficient number, appoint a 'committee of inspection' by a resolution to that effect, as we shall see in later. It should also be remembered that after the result of voting has been declared the chairman is not *functus officio* (*Hickman* v. *Kent Sheep Breeders*, (1920) 36 *T. L. R.* 528). In this particular case the chairman counted the votes and declared the motion carried, but having some doubt he had a recount. This was objected to on the ground that having declared the motion carried he was *functus officio* and could not therefore enforce a valid recount. It was held that that argument was wrong in view of the fact that though the chairman declared the motion carried, he was in doubt whether he was right or not and was therefore entitled immediately to have the votes counted again. If the chairman, in breach of his duty, wrongfully leaves the meeting before the business is completed, another qualified person may be selected by the meeting to occupy the chair, and the business carried on under these conditions will be valid.

If, however, the chairman has rightly closed the meeting anything done thereafter is void (*R.* v. *Winchester* (1806) 7 *East*, 573; *R.* v. *Buller,* (1807) 8 *East,* 389).

With regard to the order of business as appearing on agenda paper, in one case at directors' board meeting the agenda showed the first business as " the consideration of transfer of shares sent to the secretary for consideration," and the next business being " the consideration whether a call should be made to meet the company's liabilities." It was held that the directors were entitled to take the business at the meeting in any order they thought proper and if they so desired to pass a resolution for a call as their first business (*Re. Crawley & Co.*, (1889) 42 *Ch. D.* 209). The chairman has a *prima facie* authority to decide all incidental questions which arise at meetings and require his immediate decision. Here the minutes taken by him in the minute book of the result of the poll or of his decisions as to those questions which incidentally arose, the said minute will be a *prima facie* evidence (*Re. Indian Zoedone Co.*, (1884) 26 *Ch. D.* 70). The fact according to the Indian Companies Act, 1913 Sec. 81 (3) it has been laid down that the declaration of the chairman that the resolution has been carried shall be deemed conclusive evidence of the fact, without proof of the number or the proportion of the votes recorded, does not prevent the Court from enquiring into the question whether the requisite proportion of votes were in fact given or whether the majority is sufficient or insufficient. The Court will have a right to grant in junction on the company preventing it from proceeding further on the resolution until this inquiry is made (*South African and Australian Exploration and Development Syndicate,* (1896) 2 *Ch.* 268), and same was the case where a declaration on the face of it shows that the statutory majority had not voted in favour of the resolution (*Re. Caratal (New) Mines Ltd.,* (1902) 2 *Ch.* 498). The general rule however is that apart from law the declaration of the chairman to the effect that a special resolution has been carried is conclusive on a show of hands

(*Re. Hadleigh Castle Gold Mines, Ltd.*, (1900) 2 *Ch.* 419; *Arnot* v. *United African Mines, Ltd.*, (1901) 1 *Ch.* 518).

We have already noted that the chairman has the right to enforce order. In case a person present behaves in a disorderly manner, the chairman has the right to order him to behave himself, or else to withdraw, and if the person persists in the misbehaviour he may be forcibly ejected. Frequently in order to strengthen his own hands the chairman fortifies himself by taking the sense of the meeting by a motion moved by himself, though of course, under the common law that is not necessary. In case of ejection no more force should be used than what is actually necessary. If the member who is being ejected resists and uses violence he may be prosecuted (*Doyle* v. *Falconer*, (1866) *L. R. I. P. C.* 328). When, however, the chairman finds that it is impossible to maintain order, he has the right to adjourn the meeting. With regard to this it may be noted that the chairman's right to adjourn a meeting depends largely on the constitution of the company or the association whose meeting he happens to preside over. If the constitution does not provide for such powers, the chairman cannot adjourn the meeting until the business is done without the consent of the members present. *Chitty, J.* in (*National Dwellings Society* v. *Sykes*, (1894) 3 *Ch.* 159), laid down as follows :—" In my opinion the power which has been contended for, is not within the scope of the authority of the chairman—namely, to stop the meeting at his own will and pleasure." He has the right to decide all points of order raised by any member present and his rulings on points of procedure are final. It was also laid down by *Lopes, L. J.*, in *Henderson* v. *Bank of Australasia*, (1890) 45 *Ch. D.* 330, that when a chairman deliberately rules that a certain amendment cannot be put, it would be improper and indecent for any shareholder to proceed to discuss the propriety of the chairman's ruling. In articles of association, power to adjourn the meeting is usually given to the chairman on condition that it may be exercised with the consent of the meeting. In such cases the chairman is

not bound to adjourn simply because the meeting wants him to do so if he himself is not inclined to do so; in other words, the legal effect of such an article is that both the chairman and the meeting must be in agreement on this point (*Salisbury Gold Mining Co.* v. *Hathorn,* (1897) *A. C.* 268). In such cases the usual wording in the articles is 'the chairman may, with the consent of the meeting, adjourn same.' If the word 'shall' were to be used instead of 'may' the chairman must obey the majority resolution of the meeting to adjourn. It is thought however that the chairman only has power to adjourn the meeting where it is impossible to conduct business properly (*R.* v. *D'Oyly,* (1840) 12 *A. & E.* 139; *R.* v. *Chester,* (1834) 1 *A. & E.* 342; *R.* v. *Wimbledon Local Board,* (1882) 8 *Q. B. D.* 459). If the chairman wrongfully adjourns a meeting and leaves the chair, the meeting may appoint another chairman and proceed with the business (*National Dwellings Society* v. *Sykes,* (1894) 3 *Ch.* 159).

An adjourned meeting is merely a continuation of the original meeting (*Wills* v. *Murray,* (1849) 4 *Ex.* 483; *McLaren* v. *Thomson,* (1917) 2 *Ch.* 261). If the articles do not require a special notice as to the date and time of the adjourned meeting the same is not necessary. An adjourned meeting can only continue and transact the business which was left over at the original meeting and cannot go outside its scope.

The chairman has the right of voting according to his qualification, *i.e.,* according to the regulations of the body whose meeting he is presiding over, and where the votes are equal on either side on any question before the meeting, he has, in his capacity as a chairman what is called a "casting vote," by the use of which he may help the meeting to arrive at a decision. It will thus be seen that the chairman has generally two rights of vote *viz.,* (1) his *deliberative* vote, which he gives in his capacity as a member of the body and (2) the *casting* vote, which he gives in case there is a tie. The first named right has been conceded on the ground that otherwise a person

with a good voting power may be conveniently got rid of by being placed in the chair. It would be a great hardship indeed in case a large shareholder who also happens to be the chairman of a company, were to be prevented from voting on a question on which he is vitally interested, because he happens to occupy the chair and thus a resolution were to be carried, or lost, contrary to his wishes, which actually could easily have been prevented through the use of his votes. The question of the casting vote, however, has been dealt with fully a little later. In case of interruptions, the chairman has no doubt the remedy open to him of calling the offenders to order and in the last resort of removing them from the meeting. Many a chairman has, however, found that a little tact, or a slight touch of humour, has frequently greater effect in bringing a troublesome person to order. Mr. Gordon Plain relates an incident from his own experience which occurred at a meeting he was presiding over in his book from which we have already quoted. He says, " I once had a buffoon whose fancy that night was to stand on his chair—a fruitful cause of disorder not so much from the antic itself, as from the vocal, attention it attracts, however, announcing that the gentleman might (if that was his mood) listen to the speeches in that posture, tranquillity was restored, and a sense of the ridiculous soon melted the clown down into his seat."

The chairman should also see that no discussion is allowed until there is some duly proposed and seconded motion or proposition before the meeting, as otherwise, the meeting may indefinitely keep on taking irrelevant matters without arriving at a decision. Any one present who sees such an irregularity in practice at a meeting, may rise to a point of order on the ground that there was no question before the meeting.

Voting by Directors

We have already seen that unless articles otherwise provide every director has one vote at a board meeting.

Of course though not entitled to vote if interested the director cannot be precluded from attending the board meeting which he has a right to do (*Grimwade* v. *B. P. S. Syndicate,* (1915) 31 *T. L. R.* 531). An interested director, though precluded from voting at a board meeting, can exercise his right to vote as a shareholder at the general meeting of the company even though the contracts which the general meeting is considering are those in which he is interested (*North West Transportation Co.* v. *Beatty,* (1887) 12 *A. C.* 589). Where all the shareholders are directors or where there is a unanimous agreement among members and the agreement is *intra vires* it will be binding even if some of the directors who vote on it were interested (*In Re. Express Engineering Works,* (1920) 36 *T. L. R.* 275; *Salomon* v. *Salomon,* (1897) 13 *T. L. R.* 46; *re. Oxted Motor Co.,* (1921) 3 *K. B.* 32).

The Indian Companies Act clearly lays down in Secs. 91A, 91B and 91C respectively as follows :—

91 A. (1) Every Director who is directly or indirectly concerned or interested in any contract or arrangement entered into by or on behalf of the company shall disclose the nature of his interest at the meeting of the directors at which the contract or arrangement is determined on, if his interest then exists, or in any other case at the first meeting of the directors after the acquisition of his interest or the making of the contract or arrangement.

Provided that a general notice that a director is a *director or a member of any specified company or is a member of any specified firm,* and is to be regarded as interested in any subsequent transaction with such firm or company, shall as regards any such transaction be sufficient disclosure within the meaning of this sub-section and after such general notice, it shall not be necessary to give any special notice relating to any particular transaction with such firm or company.

(2) Every director who contravenes the provisions of sub-section (1) shall be liable to a fine not exceeding one thousand rupees.

(3) *A register shall be kept by the company in which shall be entered particulars of all contracts or arrangements to which sub-section (1) applies, and which shall be*

open to inspection by any member of the company at the registered office of the company during business hours.

(4) *Every officer of the company who knowingly and wilfully acts in contravention of the provision of sub-section (3) shall be liable to a fine not exceeding five hundred rupees.*

91 B. (1) No director shall, as a director, vote on any contract or arrangement in which he is either directly or indirectly concerned or interested *nor shall his presence count for the purpose of forming a quorum at the time of any such vote,* and if he does so vote, his vote shall not be counted.

Provided that the directors or any of them may vote on any contract of indemnity against any loss which they or any one or more of them may suffer by reason of becoming or being sureties or surety for the company.

(2) Every director who contravenes the provisions of sub-section (1) shall be liable to a fine not exceeding one thousand rupees.

(3) This section shall not apply to a private company.

Provided that where a private company is a subsidiary company of a public company, this section shall apply to all contracts or arrangements made on behalf of the subsidiary company with any person other than the holding company.

91 C. (1) Where a company enters into a contract for the appointment of a manager *or managing agent* of the company in which contract any director of the company is directly or indirectly concerned or interested, or varies any such existing contract, the company shall *within twenty-one days from the date of entering into the contract or varying of the contract,* send an abstract of the terms of such contract or variation, as the case may be, together with a memorandum clearly indicating the nature of the interest of the director in such contract, or in such variation to every member; and the contract shall be open to the inspection of any member at the registered office of the company.

(2) If a company makes default in complying with the requirements of sub-section (1) it shall be liable to a fine not exceeding one thousand rupees; and every officer of the company who knowingly and wilfully authorises or permits the default shall be liable to the like penalty.

It may be noted that in the above case of interested

directors, the director who is thus disqualified from voting must not even be counted in reckoning a quorum and this rule cannot be evaded even by splitting the resolution or reducing the quorum (*Re. Greymouth-Point Elizabeth Ry. Co.,* (1904) 1 *Ch.* 32; *Rama Swami* v. *Madras Times Co.,* (1915) 38 *Mad.* 991; *Re. North Eastern Insurance Co.,* (1919) 1 *Ch.* 198; *re. Sir Hormasji A. Wadia,* (1921) 23 *Bom. L. R.* 1104).

Committees appointed by Directors

It is quite usual in large companies for the board to divide itself into a number of committees, such as the finance committee, the works committee, the shares transfer committee, the general purposes committee, etc., to each of which special functions are allocated. This can only be done where the articles of the company concerned permit such delegation. When appointing the committee care should be taken to state the quorum, otherwise it would be presumed that the delegation is to the whole body and that all must be present and the power to act to the number less than the delegated authority of the committee is not presumed. Neither can they add to their number to supply a vacancy (*Re. Liverpool Household Stores, Association,* (1890) 59 *L. J. Ch.* 616 *at p.* 624). These committees look after the administration of their respective sphere of work and report at fixed intervals to the general board who formally adopts their report. Special minute books are maintained to record minutes of the work of each of these committees. The finance committee looks after the financial problems, the works committee deals with the work of the adminstration, the share transfer committee deals with the transfer application for shares, etc. This division of work brings about the best result both with regard to the economy of time and labour, and efficiency of administrative work through its concentration in the hands of those who happen to be most capable to deal with same. Where such a committee is appointed an excessive exercise of the powers of the said committee may

be ratified by the directors (*Bolton Partners* v. *Lambert*, (1889) 41 *Ch. D.* 295 *C. A.*). The simple act of delegation by the directors does not divest the board of directors of their own powers (*Huth* v. *Clarke*, (1890) 25 *Q. B. D.* 391). This committee may even consist of one person (*Re. Taurine Co.*, (1884) 25 *Ch. D.* 118).

Law relating to Minutes

The minutes are confirmed or passed as correct record either at the same meeting or at a subsequent meeting at which, as we have seen, only those present at that meeting can vote. Thus if, subsequent to the passing of the minutes, some irregularity has been found out, the best course is to pass a resolution to the effect that the minutes on a particular date are not accurate, but the minutes should not be scored out and corrected by the secretary on his own responsibility or by the president (*Crawley & Co.*, (1889) 42 *Ch. D.* 209). Minutes are not conclusive evidence of what actually took place at the meeting and if anything happens over a resolution that was passed the same may be proved in a Court of Law by evidence (*Knight's Case*, (1867) *L. R.* 2 *Ch.* 321). The minutes when signed by the chairman are *prima facie* evidence and not conclusive for that reason. If anything which as recorded is not accurate, that may also be proved in a Court of Law and the minutes thus falsified. In the absence of any contrary evidence according to the Indian Companies Act, Sec. 83 (3) the minutes of the proceeding shall be deemed to be correct and the meeting shall be deemed to have been duly called and held and all appointments of directors or liquidators shall be deemed to be valid. In one case where minutes of directors' meetings of a company consisting of a number of loose leaves fastened together in two covers was tendered in evidence as a book within the meaning of S. 120 of English Companies Act, 1929, it was held that the document being in form in which it was possible to take something out, it was not a book within S. 120 of the Act. *Heart of Oak Assurance Co., Ltd.* v.

James Flower & Sons, (1936) 1 *Ch.* 76 in which it was also held that it is improper to remove a page from the minute book. If necessary the minutes may be re-written and a line drawn across cancelled portion or page in its place. If the minute book is mutilated it gives rise to suspicion of bad faith. The same section also lays down that every company shall cause minutes of all proceedings of general meetings and of its directors to be entered in books kept for that purpose. *The books containing the minutes of proceedings of any general meetings of a company held after the commencement of the Indian Companies (Amendment) Act, 1936, shall be kept at the registered office of the company and shall during business hours (subject to such reasonable restrictions as the company may by its articles or in general meeting impose so that no less than two hours in each day be allowed for inspection) be open to the inspection of any member without charge. Any member can at any time after seven days from the meeting be entitled to be furnished within seven days after he has made a request in that behalf to the company with a copy of any minutes referred to in sub-section (4) at a charge not exceeding six annas for every hundred words. In case of refusal of inspection or failure to furnish copy as above within the time specified, the company and every officer of the company who is knowingly and wilfully in default shall be liable for each offence to a fine not exceeding twenty-five rupees and to a further fine of twenty-five rupees for every day during which the default continues. In case of any such refusal or default, the Court may by order compel an immediate inspection of the books in respect of all proceedings of general meetings or direct that the copies required shall be sent to the persons requiring them* [*Sec. 83* (*4*) (*5*) (*6*) (*7*)]. This of course only applies to minutes of general meetings of shareholders, because, as we have already seen minutes of proceedings of directors' meetings are open to the directors only. It may be added that the law requires one common minute book as minimum,

but in practice separate minute books are kept for board of directors as well as for each of the committees as well as for general meetings as we have already seen. Thus an entry of an allotment of shares to a director who was present, and who signed the minutes at the next meeting was considered to be sufficient agreement to take shares, but not in case of one who was not present and denied all knowledge (*Llanharry Haematite Iron Ore Co., Re. Roney's Case, Stock's Case,* (1864) 33 *L. J. Ch.* 731; *Tothill's Case,* (1865) 1 *Ch.* 85). In another case where there was a record of forfeiture of shares by a resolution on the minute, in absence of other evidence the Court presumed that the resolution was duly passed (*Knight's Case,* (1867) 2 *Ch. Appl.* 321; *Re. Fire-Proof Doors, Ltd.,* (1916) 2 *Ch.* 142).

Director's Right of Inspection of Minutes

Generally speaking the director has a right to inspect and take copies of the documents or books of the company, which is a right of his office according to *J. North, in Burn* v. *London and South Wales Coal Co.,* (1890) 7 *T. L. R.* 118. But where there had been a quarrel among directors and one of the directors wanted to inspect the minutes from an hostile motive, the inspection was refused (*Turner, L. J. Nicol's Case,* (1858) 3 *De. G. & J.* 387).

Responsibility of Directors Re. Board Meetings

The directors, after allotting the shares, must see that cheques received are immediately cashed. In fact the correct course under the present Indian law would be not to go to allotment until the cheques are cashed because cheques are not considered as cash (*Glasgow Pavilion* v. *Motherwell,* (1903) *Court of Sess.* 6 *F.* 116). Doubt was thrown on this problem in (*Mears* v. *Western Canada Pulp and Paper Co.,* (1905) 2 *Ch.* 353; *Burton* v. *Bevan,* (1908) 2 *Ch.* 240). *The amount received in respect of application on the minimum subscription as stated in the prospectus must be deposited and kept in a scheduled bank as defined in the Reserve Bank of India Act, 1934, until returned in*

accordance with the provisions of sub-section (4) of S. 101 or until the certificate to commence business is obtained under S. 103. In event of any contravention of this requirement every promoter, director or any person knowingly responsible for such contravention shall be liable to a fine not exceeding five hundred rupees [S. 101 (2B) and (2C)]. The other important point is that under Sec. 101 of the Indian Companies Act, 1913, no allotment shall be made of any share capital of the company offered to the public for subscription unless among other things the amount fixed if any by the prospectus as the minimum subscription upon which the directors may proceed to allotment, has been subscribed for or if no amount is so fixed and named then the whole amount of the share capital offered for subscription has been subscribed. Here, the other condition is that the amount payable on application on each share shall not be less than 5 per cent. of the nominal amount of the share concerned. If the directors violate the requirements of the law and allot in contravention of this provision under Sec. 102 the allotment shall be voidable at the instance of the applicant within one month after the holding of the statutory meeting of the company and not later *or in any case where the company is not required to hold a statutory meeting or where the allotment is made after the holding of the statutory meeting within one month after the date of the allotment and not later,* and shall be voidable notwithstanding that the company is in course of being wound up. Over and above this the same section lays down that all the directors who knowingly contravene or permit or authorise the contravention of these requirements, will be liable to compensate the company and the allottee respectively for any loss, damages or costs which the company or the allottee may have sustained or incurred thereby. The time-limit within which the proceedings for damages or costs in such cases is allowed to be taken is within two years from the date of allotment. The directors must thus be very careful while passing a resolution for allotment. If the minimum subscription is not applied for

according to Sec. 101, within 120 days from the first issue of the prospectus of the company, all money received from applicants for shares must be forthwith repaid to them with interest, and in case if any money is not so repaid within 130 days after the issue of the prospectus, the directors are jointly and severally liable to repay that money with interest at the rate of 7 per cent. per annum from the expiration of 130th day, provided, of course, that a director proves that the loss of money was not due to any misconduct or negligence on his part. In spite of Sec. 86 of the Indian Companies Act if the appointment of directors is not made in accordance with the provisions of the articles or in case they act without being re-elected after their period of office expires, they cannot allot shares, make calls or forfeit shares, these being matters entirely between the company and the shareholders (*London and Southern Counties Land Co.*, (1886) 31 *Ch. D.* 223; *Type Mutual Association* v. *Brown,* (1896) 74 *L. T.* 283). A director is not responsible for acts done at a board meeting where he is not present simply because he voted for confirmation of the minutes (*Burton* v. *Bevan,* (1908) 2 *Ch.* 240). The other case on the point is in *Re. The Lands Allotment Co.*, (1894) 1 *Ch.* 616, where two directors, *viz.*, Brock and Theobold were not present at a meeting where a resolution to invest £25,000 in shares of a particular company was passed. This resolution was *ultra vires.* When it was sought to fix the liability on both the directors the Court relieved Theobold from all responsibility but in case of Brook who at a subsequent meeting presided and stated that he had carefully considered the matter and deemed it desirable to exercise the right of subscription, etc., was held liable. In a famous case *viz.*, in *Re. City Equitable Fire Insurance Co., Ltd.*, (1925) *Ch. D.* 407, it has been laid down that "the manner in which the work of a company is to be distributed between the board of directors and the staff is a business matter to be decided on business lines. The larger the business carried on by the company the more numerous

and more important the matters that must be left to the managers, accountants and the rest of the staff." Thus in ascertaining the duties of a director of a company it is necessary to consider the nature of the company's business and the manner in which the work of the company is reasonably in the circumstances, and consistently with the articles of association distributed between the directors and the other officers of the company. "A director must act honestly and must exercise such degree of skill and diligence as would amount to the reasonable care which an ordinary man might be expected to take in the circumstances on his own behalf," but at the same time it was laid down that "the director need not exhibit in the performance of his duties a greater degree of skill and diligence than may reasonably be expected from a person of his knowledge and experience. A director is not liable for mere errors of judgment nor is he bound to give continuous attention to the affairs of the company because his duties are of an intermittent nature to be performed at periodical board meetings and at meeting of any committee to which he is appointed. It was further laid down that though a director is not bound to attend all such meetings he ought to attend them when reasonably able to do so. A director who signs a cheque that appears to be drawn for a legitimate purpose, is not responsible for seeing that the money is in fact required for that purpose, or that it is subsequently utilised for that purpose, provided, of course, the cheque came before him for signature in the regular way having regard to the usual practice of the company. A director has, of necessity to trust the officials of the company to perform properly and honestly the duties allotted to them. It is also the duty of each director to see that the company's moneys are from time to time in a proper state of investment, except so far as the articles of association may justify him in delegating that duty to others. The proposition that the director is not bound to attend every meeting of the directors or to take part in every transaction which is considered at the board meeting is an old pro-

position (*Perry's Case*, (1876) 34 *L. T.* 716). In one case where a director had not attended a board meeting for four years he was held not responsible for fraudulent reports and balance sheets (*Denham* (*Charles*) *and Co.*, (1883) 25 *Ch. D.* 752).

Unless the articles provide that the directors must follow the directions given to them by the company in general meeting it will not be within the power of the company except by a special resolution to take over the conduct of the business out of the hands of the directors or to force them to act in any particular manner (*Automatic Self-Cleansing Filter Co.* v. *Cunningham*, (1906) 2 *Ch.* 34; *Salmon* v. *Quin and Axtens*, (1909) *A. C.* 442; *Gramophone and Typewriter* v. *Stanley*, (1908) 2 *K. B.* 89 *at p.* 105).

FORMS OF RESOLUTIONS

Appointment of a Committee for a Particular Purpose

RESOLVED :—That a committee made up of Messrs. Raghuji and Babaji, members of this board, be and is hereby appointed to investigate and report on the question of the desirability of opening a branch office in Poona, and to report to this board their opinion and recommendations on this question after investigation.

Appointment of a Branch Manager

RESOLVED :—That Mr. R. Simpson be and is hereby appointed a branch manager of the office of this company in Surat, on a salary of Rs. 300 per month, for a period of three years, commencing from 1st January, 1931; and that Mr. Ramnant the chairman and director, and Mr. Handiman, the secretary, be and are hereby empowered to execute on behalf of the company, a power of attorney in favour of Mr. Simpson, the said branch manager, in such form as the company's legal advisers may deem necessary, to enable him to act in the capacity of the branch manager of Surat.

Appointment of a Committee for General Purposes

RESOLVED :—That a committee of the following directors, *viz.*, Messrs. A, B, C and D, be styled the 'general purposes committee,' and that a monthly report of such committee's proceedings be duly entered in a 'general purposes committee minute book,' to

be specially provided for that purpose, and that such reports, when duly approved by the board, be considered as part of the minutes of the board, and read in conjunction therewith.

Appointment of a Finance Committee

RESOLVED :—That a finance committee, consisting of three directors, *viz.*, Messrs. A, B and C, of which Mr. A shall be the chairman, be and is hereby appointed to take effect from this day and to hold office for a period of six months from the date hereof; and that the secretary is hereby directed that all propositions relating to outlay or expenditure, immediate or prospective, as well as all financial statements, such as abstracts of receipts and payments prepared periodically as may be fixed by the said committee, or any other financial arrangement whatsoever, must be first submitted to said finance committee to be reported upon, before being placed before the board.

Closing of Transfer Book

RESOLVED :—That transfer books of the company be and are hereby closed from 17th June, 1937 to 2nd July, 1937.

Resolution for Adoption for Seal and Custody of Keys

RESOLVED :—That the seal of the company produced by the secretary an impression of which is affixed on to these minutes be hereby adopted as the signature of the company.

That the key of lock no. 1 of the said seal be kept in the custody of the chairman and a key of lock no. 2 be held by the secretary and that the duplicate keys thereof be kept with the company's bankers in safe custody.

Adoption of Draft Prospectus

RESOLVED :—That the draft prospectus as read out to the board by Mr. X, the lawyer of the company be approved and adopted. That the said prospectus be signed by all the directors and dated the 15th March, 1937, and that the secretary be instructed to file one copy of same duly signed with the registrar of joint stock companies.

Adoption of Annual Reports and Accounts

RESOLVED :—That the reports and accounts for the year ended 31st December, 1937, and as audited and certified by the company's auditors as produced before the board be approved and adopted.

Calling upon an Officer to Resign

Resolved :—That Mr. X, the Accountant of the company be requested to resign from his office as from 31st December, 1937 and that the secretary is authorised and instructed to communicate to him the terms of this resolution.

For Allotment of Shares

Resolved :—That the 100 ordinary shares of Rs. 1,000 each numbered consecutively from 1 to 100 be allotted to the applicants on the List A whose applications have been recommended for acceptance by the allotment committee according to the numbers set opposite to their respective names and that the secretary be instructed to forward letters of allotment to the said allottees and letters of regret to those applicants to whom no allotment has been made returning therewith their application money.

Making a Call

Resolved :—That a second call of Rs. 100 per share be made upon all the ordinary shares of the company making in all Rs. 500 per share called up, the said call to be payable on or before 5th January, 1934, to the company's bankers, the Bank of India Ltd., at their Esplanade Road, head office, and that the secretary is hereby instructed to issue the necessary call notices and arrangement with the company's bankers for the collection of call money.

Forfeiture of Shares

Resolved :—That Mr. X, a shareholder of the company having failed to pay the second call of Rs. 10 each made on the 10 ordinary shares held by him and payable on or before 15th January, 1937, numbered consecutively from 101 to 110 (inclusive) in spite of the notice served upon him on 1st January, 1937, in the terms of the articles of association Nos. 36 and 37 the said shares be and are hereby forfeited.

Passing of Transfers

Resolved :—That the transfer application nos. 65 to 89 (inclusive) be and are hereby passed and the seal be affixed to the new certificates nos. 3030 to 3054 (inclusive) and that the names of the said transferee be entered in the register of members of this company.

CHAPTER XIII

Shareholders' Meetings

The ordinary business of a joint stock company is usually transacted by the board of directors, particularly in case of public companies, but there are a large number of transactions which according to the requirements of the Indian Companies, Act, 1913, or those of articles of association of the companies concerned, can only be done with the approval of the shareholders or members of the company in a general meeting duly convened. This is because according to the first principle of law laid down as early as 1745 by Lord Hardwicke in *Attorney General* v. *Davy*, (1745) 2 *Atk.* 212, and which applies to all corporations, *i.e.*, bodies incorporated under some Act, "whenever a certain number are incorporated a major part may do any corporate act, so if all are summoned and part appear, a major part of those that appear may do a corporate act." Frequently this rule is surmounted by the articles of association of a particular company providing that a certain number, which may not be a majority number, shall form a quorum, in which case even a majority of the minority present are legally qualified to do a corporate act. As we shall see later, certain rules and regulations as to the convening of meeting and proper notice being given to each and every member within summonable distance, have to be complied with, though the general principle happens to be that where all the members of a company are present any irregularity as to the giving of the notice is set right by their consent (*Express Engineering Works,* (1920) 1 *Ch.* 466). The common law rule of meeting is that there shall be at least two to constitute a meeting and that a single member cannot constitute a meeting (*Sharp* v. *Dawes,* (1876) 2 *Q. B. D.* 26). In company matters, one

thing at least is conceded and that is in case of class meetings, *i.e.*, to say the meetings of shareholders, of one particular class, say preference shareholders, if one person were to hold all the shares of that class, the requirements as to the meeting of that class are satisfied when that one person who holds all the shares signs the resolution in writing which is sought to be passed (*East* v. *Bennett Bros.*, (1911) 1 *Ch.* 163).

Classification of General Meetings

The meetings of the shareholders of a joint stock company are classified under four separate headings as follows :—

1. The statutory meeting.
2. The annual general meeting.
3. Extraordinary general meeting.
4. Class meetings.

Statutory Meeting

This meeting is virtually speaking the first meeting that a joint stock company usually holds and the object seems to be to ensure that at the earliest opportunity the members of the company should have an opportunity to secure first-hand information as to the exact position of the company, particularly in relation to its financial success in floatation, as well as other information as to the investment of its capital in the different branches of the enterprise for which the company is incorporated.

The Indian Companies Act, Sec. 77 lays down that :—

(1) Every company limited by shares *and every company limited by guarantee and having a share capital shall, within a period of not less than one month nor more than six months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company, which shall be called the statutory meeting.*

(2) The directors shall, at least *twenty-one* days before the day on which the meeting is held, forward a report (in this Act *referred to as* "the statutory report") *certified as required by this*

section to every member of the company and to every other person entitled under this Act to receive it.

(3) The statutory report shall be certified by not less than two directors of the company or *by the chairman of the directors if authorised in this behalf by the directors* and shall state :—

(*a*) the total number of shares allotted, distinguishing shares allotted as fully or partly paid up otherwise than in cash, and stating in the case of shares partly paid up the extent to which they are so paid up, and in either case the consideration for which they have been allotted;

(*b*) the total amount of cash received by the company in respect of all the shares allotted distinguished as aforesaid;

(*c*) an abstract of the receipts of the company *of the payments made thereout upto a date within seven days of the date of the report,* exhibiting under distinctive headings the receipts of the company from shares, debentures and other sources, the payments made thereout and particulars concerning the balance remaining in hand and an account or estimate of the preliminary expenses of the company *showing separately any commission or discount paid on the issue or sale of shares;*

(*d*) the names, addresses and descriptions of the directors, auditors, *managing agents* and managers, (if any) and secretary of the company *and the changes, if any, which have occured since the date of the incorporation;*

(*e*) the particulars of any contract, the modification of which is to be submitted to the meeting for its approval, together with the particulars of the modification or proposed modification;

(*f*) *the extent to which underwriting contracts, if any, have been carried out;*

(*g*) *the errors, if any, due on calls from directors, managing agents and managers; and*

(*h*) *the particulars of any commission or brokerage paid in connection with the issue or sale of shares to any director, managing agent or manager or a partner of the managing agent if the managing agent is a firm or if the managing agent is a private company a director thereof.*

(4) *The statutory report shall, so far as it relates to the shares allotted by the company and to the cash received in respect of such shares and to the receipts and payments of the company, be certified as correct by the auditors of the company.*

(5) The directors shall cause a copy of the statutory report, certified as required by this section to be *delivered* with the registrar, *for registration forthwith,* after the sending thereof to the members of the company.

(6) The directors shall cause a list showing the names, descriptions and addresses of the members of the company, and the number of shares held by them respectively, to be produced at the commencement of the meeting, and to remain open and accessible to any member of the company during the continuance of the meeting.

(7) The members of the company present at the meeting shall be at liberty to discuss any matter relating to the formation of the company, or arising out of the statutory report, whether previous notice has been given or not, but no resolution of which notice has not been given in accordance with the articles may be passed.

(8) The meeting may adjourn from time to time, and at any adjourned meeting any resolution of which notice has been given in accordance with the articles, either before or subsequently to the former meeting, may be passed, and adjourned meeting shall have the same power as an original meeting.

(9) If a petition is presented to the Court in manner provided by Part V for winding up the company on the ground of default in filing the statutory report or in holding the statutory meeting, the Court may, instead of directing that the company be wound up, give directions for the statutory report to be filed or a meeting to be held, or make such other order as may be just.

(10) *In the event of any default in complying with the provisions of this section every director of the company who is guilty of or who knowingly and wilfully authorises or permits the default shall be liable to a fine not exceeding five hundred rupees.*

(11) *This section shall not apply to a private company.*

From the above section it will be noticed that the meeting has to be held within a period of not less than one month nor more than six months "from the date at which the company is entitled to commence business." In case of a private company it is entitled to commence business from the date of registration, whereas in case of a public company it cannot commence business unless after incorporation it has carried out various regulations of the law and satisfied the registrar of joint stock companies that this has been done. The registrar, when satisfied it has done so, issues a certificate called a "certificate entit-

ling the company to commence business." It may be noted that Sec. 77 which provides for the holding of a statutory meeting and issue and registration of a statutory report does not according to Sec. 77 (11) apply to a private company. The other requirement is that the notice convening the Statutory Meeting must state that it is the Statutory Meeting (*Gardner* v. *Iredale*, (1912) 1 *Ch.* 700). The default in holding this statutory meeting or in filing the statutory report is under Sec. 162 of the Indian Companies Act, 1913 a ground for winding up of the company. The statutory report has to be sent to all members together with a notice of the meeting at least ten days before the day on which the meeting is held; this includes not only the holders of ordinary shares, but also those who hold preference shares. The debenture holders are also entitled to receive this statutory report (Sec. 146 of the Indian Companies Act). The statutory report, as far as it relates to the shares allotted by the company and the cash received in respect of the shares, plus receipts in payment of the company on capital account, must be certified as accurate by the auditors of the company. In the case of public companies this report must be filed with the registrar forthwith after sending same to the members of the company.

Preparation and Drafting of the Report

In drafting a report the best course is to divide same under appropriate headings and to deal with each in separate paragraphs. The statutory report is compulsory under the Indian Companies Act, 1913, Sec. 77 (this corresponds to Sec. 65 of the English Companies Act of 1929) and is to be prepared and submitted to shareholders of every joint stock company limited by shares, twenty-one days (seven days in England) before the statutory meeting, to be held within not less than one month and not more than six months (three months in England) of the company's commencement of business.

THE STATUTORY REPORT

THE HEERAMANECK SPINNING AND WEAVING COMPANY, LTD., REPORT.

Pursuant to Sec. 77 of the Indian Companies Act, 1913.

(1) The total number of shares allotted is 2,000 of Rs. 1,000 each. Of this 500 are Founders Shares allotted fully paid and 1,500 Ordinary Shares, of which 200 were paid to vendors in part payment of the purchase consideration as provided by the Agreement of 18th January, 1937.

(2) The total amount of cash received by the company on the 1,300 Ordinary Shares is Rs. 6,50,000.

(3) The following is an abstract of receipts and payments of the company on capital account to the date of this report :—

RECEIPTS.			PAYMENTS.		
Ordinary Shares—			On account of Preliminary Expenses ..	Rs.	4,950
Applications and Allotment	Rs.	6,50,000	Commission paid on the issue of Shares ..	„	2,000
			On account of Purchase to Vendors	„	18,000
			Office Furniture	„	5,000
			Machinery	„	1,12,000
			Building ..	„	50,000
			Balance—		
			Imperial Bank of India	„	4,57,000
			In hand	„	1,050
	Rs.	6,50,000		Rs.	6,50,000

(4) The preliminary expenses of the company are estimated at Rs. 10,000. Commission paid on the issue of share was Rs. 2,000.

(5) The names, addresses and descriptions of the directors, auditors, managing agents and secretaries of the company are the following :—

I. Directors.—

Raja Saheb Shivlal Nanchand, (*Chairman*).

Address :—Malabar Hill, Bombay.

Sir Robert Mackinley, (*Baronet*).
Address :—Colaba, Bombay.
Sir Bholabhai Nathuchand, (*Knight*).
Address :—Bhuleshwar, Bombay.
Cawasji M. Indorewala, Esq.,(*Merchant*).
Address :—Grand Road, Bombay.

II. Auditors.—
Robertson and Chandulal, (*Govt. Certified Auditors*).
Address :—Church Gate Street, Bombay.

III. Managing Agents.—
Messrs. C. M. Indorewala & Co.
Address :—6, Hornby Road, Bombay.

IV. Secretary.—
J. Hardwork, Esq.
Address :—Wodehouse Road, Fort, Bombay.

V. Contract dated................with Messrs. C. M. Indorewala & Co., managing agents as referred to in the prospectus has been modified by the board of directors in the following particulars :—

(1) That their office allowance as provided in clause 5 of their agreement be raised from Rs. 1,000 a month to Rs. 1,200 a month.

(2) That their commission on net profits as provided for in Clause 6 of the agreement be reduced from 10 per cent. to 8 per cent.

The directors beg to submit their modifications for the approval of the meeting.

VI. All the underwriting agreements have been fully carried out.

VII. There are no arrears at the date of this report due on calls made from directors and managing agents. No brokerage or commission is paid or to be paid in connection with the issue or sale of shares to any director or managing agents or any partner of the managing agents firm.

We, the undersigned directors of the above-named company certify that the above report is correct.

Dated the 12th of June, 1937.
SHIVLAL NANCHAND
ROBERT MACKINLEY
BHOLABHAI NATHUCHAND
CAWASJI M. INDOREWALA
} *Directors.*

Directors,

We hereby certify that the foregoing report, so far as it relates to the shares allotted by the company and to the cash

received in respect of the shares, and to the receipts and payments of the company on capital account is correct.

Bombay, 15th June, 1937.

Robertson and Chandulal,
Registered Accountants.
(Auditors).

Notice re. Statutory Meeting

The notice convening the statutory meeting will have to be made out in a form similar to the one given below :—

THE BOMBAY TRADING & MANUFACTURING CO., LTD.
NOTICE OF THE STATUTORY MEETING

NOTICE is hereby given that the statutory meeting of the above company pursuant to Sec. 77 of the Indian Companies Act, 1913, will be held at the Registered Office of the company at 15, Esplanade Road, Bombay, on Tuesday, the 20th July, 1937.

Bombay, 16th June, 1937.

By Order of the Board,
G. UMRIGAR,
Secretary.

Proceedings

At this meeting only the shareholders can attend and they are at liberty to discuss matters covered by the report sent to them, *viz.*, the formation of the company, particulars as to the amounts collected against paidup capital, how the same was spent in form of preliminary expenses, purchase of the various assets, etc., and any matter relating to the formation of the company, or arising out of the report of which whether previous notice has been given or not. Besides this it is the directors' duty at this meeting to cause a list showing names, descriptions and addresses of members of the company, and the number of shares held by them respectively, to be produced at the commencement of meeting and to remain open and accessible to any member during the continuance of the meeting. There is no objection to the statutory meeting being adjourned from time to time, and any resolution passed at this adjourned meeting will have

the same force as one passed at the original meeting, provided proper notice, as required by the articles of association of the company concerned, has been given. The statutory report must be certified by not less than two directors of the company and when there are less than two directors by the sole director and manager.

AGENDA OF A STATUTORY MEETING

AGENDA

(1) To read the notice convening the meeting and the statutory report circulated may be taken as read.

(2) The chairman to explain the purpose for which the meeting has been called under Sec. 77 of the Indian Companies Act, 1913.

(3) Chairman's statement as to the general position of the company in connection with the floatation, etc., and invitation to members to ask such questions as may arise out of the report or relating to the formation of the company.

Minutes of the Statutory Meeting

BOMBAY TRADING COMPANY, LIMITED.

The statutory meeting of the above company was held at the registered office of the company on Friday, 14th June, 1937 at 4 p.m. (S. T.).

There were present :—

Sir Sorabji Framji, Kt. (*Chairman*).
Mr. W. Lalchand.
Mr. Mohamed Karim.
Mr. M. S. Kavarana.

Directors.—

In attendance :—

Mr. Melwanji Cawasji (*Solicitor*).
Mr. M. Pochkanawalla (*Secretary*).

Shareholders according to the separate list filed.

The notice convening the meeting was read out by the secretary on instructions from the chairman and it was resolved that the report which was duly circulated among members might be taken as read.

Sir Sorabji (Chairman) then explained that the meeting was called to comply with the requirements of Sec. 77 of the Indian Companies Act, 1913, where the shareholders were invited to meet in order to ascertain the precise position as to floatation and the

prospects of the company, that the list showing the names, descriptions and addresses of the members of the company and the number of shares held by them respectively, was available at the meeting and would remain open and accessible to any of the members of the company present for inspection during the continuance of the meeting.

The chairman then dealt with details as to the general position of the company and referred to and explained some of the items of the report. He then invited those present to discuss any matter relating to the formation of the company, or arising out of the statutory report, whether previous notice had been given or not. He pointed out, however, that no resolution can be passed of which no notice had been given.

Certain number of the shareholders asked questions which were duly answered. After a short discussion the meeting terminated with a vote of thanks to the chair.

NOTE :—We have already dealt with the consequences of default in holding the meeting or filing the statutory report, they are :—

(1) that the company may be ordered to be wound up by the Court (Sec. 162) or

(2) the Court may, when the petition is presented to it for winding up of the company on this ground, instead of ordering winding up, order the filing of the statutory report or holding of the statutory meeting [Sec. 77 (9)].

GENERAL MEETING

A general meeting of a joint stock company is a meeting of its members, or its shareholders, duly convened according to the terms and conditions of the articles of association or requisition of members as provided for by Sec. 78 of the Indian Companies Act. *Prima facie* all shareholders of the company are at liberty to attend this meeting. Sec. 76 of the Indian Companies Act lays down in connection with the general meeting as follows :—

76. *(1) A general meeting of every company shall be held within eighteen months from the date of its incorporation and thereafter once at least in every calendar year and not more than fifteen months after the holding of the last preceding general meeting.*

(2) If default is made in holding a meeting in accordance with the provisions of this section, the company and every director or manager of the company who is knowingly and wilfully a party

to the default shall be liable to a fine not exceeding five hundred rupees.

(3) If default is made as aforesaid, the Court may, on the application of any member of the company, call or direct the calling of a general meeting of the company.

The above section makes it compulsory that (1) *within eighteen months from the date of its incorporation*, and thereafter (2) once at least in every calendar year (3) and not more than fifteen months after the holding of the last preceding general meeting, this annual general meeting has to be held. Failing the compliance with either of these requirements, an offence is committed and the fine as provided for by this section will be levied. The calendar year, of course, commences from 1st January and ends on 31st December (*Gibson* v. *Barton*, (1875) *L. R.* 10 *Q. B.* 329). If the meeting is not called at least once in the calendar year and is also not called within the fifteen months from the date of the last meeting, two separate offences are committed and the party charged will be separately fined for each offence (*Smedley* v. *Companies' Registrar,* (1919) 1 *K. B.* 97). Of course in case of this default in calling the meeting the Court may, on the application of any member of the company, call or direct the calling of a general meeting of the company. [Sec. 76 (3)]. The further point to be remembered is that when the articles of association of the company concerned make a distinction between an ordinary and an extraordinary general meeting, the extraordinary meeting held on the requisition of shareholders does not come within definition of general meeting under Sec. 76 (*Emperor* v. *Nasur,* (1923) 25 *Bom. L. R.* 224). In *Gibson* v. *Barton*, referred to above *Blackburn, J.* laid down that "no individual director, nor a manager, probably, has the power, certainly no one of them has the strict legal right, to call a meeting. A meeting is to be called by order of the directors and not by any individual person." In one case where the secretary on a requisition sent out a notice convening an extraordinary meeting which purported to

be issued by order of the board, when in fact no such order was issued, it was held that on ratification by the directors of the said notice it became good for all purposes (*Hooper* v. *Kerr, Stuart & Co. Ltd.*, (1900) 83 *L. T.* 729). In case of a meeting of the subscribers of the memorandum any reasonable notice will do. In one case two days' notice was held sufficient (*John Morley Building Co.* v. *Barras* (1891) 2 *Ch.* 386). In case of urgency a mandatory injunction is granted by the Court directing the directors to call a meeting forthwith as was done in England under Sec. 66 (1) of the Act of 1908 corresponding to our section of the present English Act of 1929 (*Rutherford* v. *Farmery,* (1915) *R. No.* 1524; *Ashbury J.* 12 *Nov.,* 1915). The New English Act has now provided for the expenses of requisitionists being paid out of the directors' remuneration if they wrongfully make default in calling a meeting, and has given the Court the power to call the meeting if it is impracticable to do so in the manner prescribed by the articles, on the application of a director or any member entitled to vote, or on its own motion (Sec. 115 (2) of the English Act of 1929).

To stop a general meeting of the company by the Court, a very strong case has to be presented (*Isle of Wight Ry. Co.* v. *Tahourdin,* (1883) 25 *Ch. D.* 320). We have seen that where a company fails to hold its annual general meeting in proper time, any member of the company may apply to the Court and the Court may call, or direct the calling of, the said meeting. Minutes of the proceedings of these meetings must be recorded in book, kept for the purpose, and shall be signed by the chairman of the meeting at which the proceedings were had, or by the chairman of the next succeeding meeting, when they shall be evidence of the proceedings. The notice of the general meeting must be given to the members, unless otherwise provided for, because the omission to do so *prima facie* invalidates the meeting (*Smyth* v. *Darley,* (1849) 2 *H. L. C.* 789). The articles of association of a good number of companies provide that accidental omission

shall not invalidate the meeting, in which case, the provision shall apply. The executors or administrators of deceased members are not entitled to notice unless registered as members, unless articles provide otherwise (*Allen* v. *Gold Reefs of W. Africa*, (1900) 1 *Ch.* 656). The usual business of this meeting is to receive the directors' report of the work done during the period preceding the date on which it is held, and to receive the balance sheet duly audited by the auditor of the company, together with the auditor's report which is generally attached thereto. The auditors' report has to be read before the company in general meeting, and shall be open to inspection by any member of the company. Following upon the directors' report, the next business is that of sanctioning the dividend, if any, and the election of the directors and auditors as the case may be. Any other business is considered to be special, and due notice has to be given. The articles of association generally set out the nature of business which is to be done at this ordinary meeting, and in some companies they provide that this meeting be held half-yearly. The usual practice is to provide in the articles for at least seven days' notice. It is at this meeting that the shareholders are in theory supposed to exercise control over the company, the nature of which control will undoubtedly depend on the powers left to individual shareholders as to voting in the memorandum or the articles of association of the company. Where *prima facie* directors were improperly appointed they were restrained from presiding over a meeting called by them as an extraordinary general meeting (*Harben* v. *Phillips*, (1883) 23 *Ch. D.* 14).

If the directors' report as presented at the general meeting is not accepted, it amounts to a vote of censure on the directors, but it has no further effect, as it is not necessary that the report should be accepted. Now under the *Indian Companies (Amendment) Act, 1936, the company may by extraordinary resolution remove any director, whose period of office is liable to determination at any time by retirement of directors in rotation before the expiration of*

his period of office and may by ordinary resolution appoint another person in his stead. The person so appointed shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose place he is appointed was last appointed director. A director so removed shall not be reappointed a director by the board of directors. [*86G* (*1*)]. Some articles of association also give the members power to remove the directors. In the absence, however, of being able to remove the directors on account of the requisite majority for an extraordinary resolution not being available the shareholders may adopt the plan of waiting till each one of them retires by rotation, and re-elect whomsoever they please. Sec. 142 of the Indian Companies Act, 1913, gives the company the power to appoint inspectors to investigate its affairs by a special resolution, which powers may be exercised by the company if necessary. Failing this, the powers under Sec. 138, namely, that of applying to the Local Government for one or more competent inspectors to investigate the affairs of the company, and to report upon it, may be resorted to. The section leaves open the following four courses under the following circumstances :—

(*i*) in the case of a banking company having a share-capital, on the application of members holding not less than one-fifth of the shares issued;

(*ii*) in the case of any other company having a share-capital, on the application of members holding not less than one-tenth of the shares issued;

(*iii*) in the case of a company not having a share-capital on the application of not less than one-fifth in number of the persons on the company's register of members;

(*iv*) in the case of a company, on a report by the registrar Sec. 137 (5).

These inspectors shall have the right to examine on oath any person in relation to the company, or its business, and to call upon all who have been officers of the company, to produce all books and documents relating to them in their custody or power. On the conclusion of their investigations the inspectors shall present their report. This

report, or a certified copy of it, authenticated by the seal of the company concerned, is admissible in legal proceedings as evidence of the opinion of the inspectors relating to matters contained therein. We have seen that there is no objection to any special business, of which due notice has been given, being done at the general meeting, though the practice followed by many companies is to hold an extraordinary meeting to consider any special matter either on a separate day, or on the same day as the annual general meeting, soon after the conclusion of this general meeting.

Where the articles provide for a notice of seven days to be given to each member it means seven clear days, *i.e.*, exclusive of the day of giving the notice and the day of the meeting (*Railway Sleepers Supply Co.*, (1885) 29 *Ch. D.* 234; *Mercantile Investment Co.* v. *International Co.*, (1893) 1 *Ch. D.* 484). So long as the notice is posted in proper time, or published in the newspapers as provided for by the articles, it is not necessary to prove that all members received it (*Sneath* v. *Valley Gold Co.*, (1893) 1 *Ch.* 477). We have already seen in connection with the statutory meeting that notice of adjournment is not necessary to be given unless the articles so provide, as the adjournment is continuation of the original meeting. In some cases, however, articles require that if an adjourned meeting is to be held after more than ten days a fresh notice should be given as in the case of Table A., Clause 49 of the English Companies Act of 1929. Once a notice of the meeting is given it cannot be adjourned by a subsequent notice, but the proper course will be to hold the meeting and resolved the adjournment of it to any future convenient date (*Smith* v. *Paringa Mines, Ltd.*, (1906) 2 *Ch.* 193). The executors or administrators, or other special representatives of a deceased shareholder, need not be given a notice of the meeting unless they have transferred their shares to their own names (*Allen* v. *Gold Reefs of W. Africa*, (1900) 1 *Ch.* 656). The notice of the meeting must give a fair, candid, and reasonable explanation of the business which is proposed to be done, because if the matter is

wrapped up and kept back the proceedings may be invalidated (*Kaye* v. *Croydon Tramways,* (1898) 1 *Ch.* 358; *Pacific Coast Coal Mines Ltd.* v. *Arbuthnot,* (1917) *A. C.* 607). With reference to meetings of a public company the following section has been substituted by the Indian Companies (Amendment) Act, 1936 in S. 79 :—

79. (*1*) *The following provisions shall have effect with respect to meetings of a company other than a private company not being a subsidiary of a public company and the procedure thereat, notwithstanding any provision made in the articles of the company in this behalf* :

(*a*) *a meeting of a company other than a meeting for the passing of a special resolution may be called by not less than fourteen days' notice in writing; but with the consent of all the members entitled to receive notice of some particular meeting that meeting may be convened by such shorter notice and in such manner as those members may think fit;*

(*b*) *notice of the meeting of a company with a statement of the business to be transacted at the meeting shall be served on every member in the manner in which notices are required to be served Table A and for the purpose of this clause the expression "Table A" means that table as for the time being in force; but the accidental omission to give notice to, or the non-receipt of notice by any member shall not invalidate the proceedings at any meeting;*

(*c*) *five members present in person or by proxy, or the chairman of the meeting, or any member or members holding not less than one-tenth of the issued capital which carries voting rights shall be entitled to demand a poll. Provided that in the case of a private company if not more than seven members are personally present, one member, and if more than seven members are personally present, two members shall be entitled to demand a poll;*

(*d*) *an instrument appointing a proxy, if in the form set out in Regulation 67 of Table A, shall not be questioned on the ground that it fails to comply with any special requirements specified for such instruments by the articles; and*

(*e*) *any shareholder whose name is entered in the register of shareholders of the company shall enjoy the same*

rights and be subject to the same liabilities as all other shareholders of the same class.

(2) The following provisions shall have effect in so for as the articles of the company do not make other provision in that behalf :

(a) two or more members holding not less than one-tenth of the total share capital paid-up or, if the company has not a share capital, not less than five per cent. in number of the members of the company may call a meeting;

(b) in the case of a private company two members and in case of any other company five members personally present shall be a quorum;

(c) any member elected by the members present at a meeting may be chairman thereof;

(d) in the case of a company originally having a share-capital, every member shall have one vote in respect of each share or each hundred rupees of stock held by him, and in any other case every member shall have one vote;

(e) on a poll votes may be given either personally or by proxy;

(f) the instrument appointing a proxy shall be in writing under the hand of the appointor or of his attorney duly authorized in writing, or if the appointor is a corporation, either under seal or under the hand of an officer or an attorney duly authorized; and

(g) a proxy must be a member of the company.

(3) If for any reason it is impracticable to call a meeting of a company in any manner in which meetings of that company may be called or to conduct the meeting of the company in manner prescribed by the articles of this Act, the Court may, either of its own motion or on application of any director of the company or of any member of the company who would be entitled to vote at the meeting, order a meeting of the company to be called, held and conducted in such manner as the Court thinks fit, and where any such order is given may give such ancillary or consequential directions as it thinks expedient, and any meeting called, held and conducted in accordance with any such order shall for all purposes be deemed to be a meeting of the company duly called, held and conducted.

The above section is an adaptation of S. 118 of the English Act of 1929 with the alteration to the effect that whereas in the English Act the section permits its provisions

to be overridden by special clauses, in the articles of association of the company concerned, the Indian Act makes provisions governing the notice to be given for official resolution, the manner of service of notices, the number of members entitled to demand a poll and the form of proxy instruments incapable of variation. In case of proxy instruments attempts were made by some articles to obstruct the shareholders from taking an organized action against the management by providing to the effect that only proxy forms issued by the company with the seal of the company to the shareholders could be used. This and similar obstructions are now made impossible by providing in S. 79 (1) (d) that any proxy form printed or prepared by any one as long as it followed the form set out in clause 67 of Table A was sufficient. The other obstruction to the shareholder exercising his right was a provision to the effect that shareholder cannot exercise his right to attend a meeting of shareholders or to vote thereat until after a fixed period as provided for in the articles (usually six months) had expired. This was also objected to by the Shareholders' Association and the investors as an unnecessary obstruction to their normal rights and has now been effectively provided by S. 79 (1) (c) *by laying down that any shareholder whose name is entered in the register of shareholders of the company shall enjoy the same rights and be subject to the same liabilities as all other shareholders of the same class. This section also provides specially that agenda must accompany the notice of a general meeting (S. 79 (1) (b).*

Thus according to the section cited above if the articles of association do not otherwise provide five members can call a meeting (*Brick & Stone Company,* (1878) *W. N.* 140; *Sorabji* v. *Scind Press Co.,* (1906) 8 *Bom. L. R.* 478). It is now further provided that if for some reason *it is impracticable to call a meeting in any manner in which company meetings may be called or to conduct the meeting in the manner prescribed by the Act or the articles the Court may order a meeting to be called on application of*

any director or member entitled to vote of the company [S. 79 (3)].

SPECIMEN FORMS OF ARTICLES IN USE BY JOINT STOCK COMPANIES IN INDIA IN CONNECTION WITH CONVENING OF GENERAL MEETINGS.

Statutory Meeting

The statutory meeting of the company shall be held at such place and time (not being less than one month and more than six months from the date at which the company is entitled to commence business), as the directors may determine.

Convening of General Meeting

The first general meeting of the company shall be held *within eighteen months from the date of its incorporation* and thereafter once at least in every calendar year at such time and place as may be determined by the directors. Such general meeting shall be called ordinary meetings, all such meetings of the company shall be called extraordinary meetings.

An alternative form is as follows :—

87. A general meeting of the company shall be held *within eighteen months from the date of its incorporation* and thereafter once at least in every calendar year and not more than fifteen months after the holding of the last preceding general meeting and at such time and place as may be determined by the board. The above-mentioned general meetings shall be called ordinary general meetings; all other general meetings shall be called extra-ordinary general meetings.

Directors may call Extraordinary Meetings

The directors may call an extraordinary meeting whenever they think fit.

Calling of Extraordinary General Meeting on Requisition

(1) The directors shall, on the requisition of the holders of not less than one-tenth of the issued share capital of the company upon which all calls or other sums then due have been paid, forthwith proceed to call an extraordinary general meeting of the company.

(2) The requisition must state the objects of the meeting, and must be signed by the requisitionists and deposited at the registered office of the company, and may consist of several documents in like form, each signed by one or more of the requisitionists.

(3) If the directors do not proceed within twenty-one days from the date of requisition being so deposited to cause a meeting to be called, the requisitionists, or a majority of them in value, may themselves call the meeting, but in either case any meeting so called shall be held within three months from the date of the deposit of the requisition.

(4) If at any such meeting a resolution requiring confirmation at another meeting is passed, the directors shall forthwith call a further extraordinary general meeting for the purpose of considering the resolution and, if thought fit, of confirming it as a special resolution, and, if the directors do not call the meeting within seven days from the date of the passing of the first resolution, the requisitionists, or a majority of them in value may themselves call the meeting.

(5) Any meeting called under this article by the requisitionists shall be called in the same manner, as nearly as possible, as that in which meetings are to be called by the directors.

Alternative articles re. the same point are as follows :—

Extraordinary general meeting.

The directors may, whenever they think fit, and they shall upon a requisition made in writing by the holders of not less than one-tenth of the issued share capital of the company upon which all calls or other sums then due shall have been paid forthwith proceed to convene an extraordinary general meeting.

Requisition for a meeting.

Any requisition made by the members shall express the object of the meeting proposed to be called, and shall be left at the registered office of the company. It must be signed by the requisitionists, and may consist of several documents in like form, each signed by one or more requisitionists.

Procedure as to meetings requisitioned.

Upon the receipt of such requisition, the directors shall within fourteen days after the receipt thereof proceed to convene an extraordinary general meeting. If they do not proceed to convene the same within twenty-one days after the receipt of the requisition the requisitionists or a majority of them in value, may themselves convene an extra-

ordinary general meeting to be held within three months from the date of the deposit of the requisition on such day and at such place as the persons convening the same may determine. In case at any such extraordinary general meeting a resolution requiring confirmation at another meeting is passed, the directors shall forthwith convene a further extraordinary general meeting, and if they do not convene the same within seven days from the date of the passing of such resolution, the requisitionists or a majority of them in value may themselves in like manner but without a further requisition convene the meeting necessary to confirm the resolution. Any meeting convened under this article by the requisitionists shall be convened in the same manner as nearly as possible as that in which meetings are to be convened by the directors.

Notice of Meetings

Not less than fourteen days' notice in writing at the least, specifying the place, the day and the hour of meeting, and in case of special business, the general nature of such business, shall be given in manner hereinafter mentioned to all members save those as are under the provisions of these articles not entitled to receive notices from the company.

NOTE :—Fourteen clear days' notice in case of meetings of the company other than a meeting for the passing of a special resolution to the members specifying the place, day and hour of meeting and in case of special business the general nature of such business shall be given either by advertisement or by notice sent by post, or otherwise served as hereinafter provided.

Notice with Agenda

Notice of the meeting of the company with a statement of the business to be transacted at the meeting shall be served on every member in the manner in which notices are required to be served by Table A.

NOTE :—The Indian Companies (Amendment) Act, 1936, Section 79 (1) (b) makes it now compulsory in case of meetings of companies to send an agenda of business to

be done at the meeting along with the notice of the meeting.

Shorter Notice

With the consent of all members save those as are under the provisions of these articles not entitled to receive notices of meetings, a meeting may be convened by a shorter notice than fourteen days and in such manner as such members may approve.

Omission to give Notice not to invalidate resolution Passed

In cases in which notice of any meeting called by the directors is given to the shareholders individually, the accidental omission to give notice to any of the members, or the non-receipt thereof, shall not invalidate any resolution passed at any such meeting.

PROCEEDINGS OF GENERAL MEETING

Business of ordinary meeting.

The business of any ordinary meeting other than the statutory meeting shall be to receive and consider the profit and loss account, the balance sheet and the reports of the directors and of the auditors, to elect directors and other officers in the place of those retiring by rotation, to declare dividends and to transact any other business which under these presents ought to be transacted at an ordinary meeting.

Special business.

All other business transacted at an ordinary meeting and all business at an extraordinary meeting shall be deemed special.

No business unless a quorum is present.

No business shall be transacted at any general meeting unless a quorum of members is present at the time when the meeting proceeds to business.

Quorum.

Three members present in or by proxy shall be a quorum for a general meeting.

When quorum is not present.

If within thirty minutes from the time appointed for the meeting a quorum is not present the meeting, if convened upon the requisition of members, shall be dissolved, in any other case it shall stand adjourned to such day in the next week and at such time and place as the board may appoint.

Quorum at adjourned meeting.

At any adjourned meeting the members present and entitled to vote whatever their number or the amount of shares or stock held by them shall form a quorum and shall have power to decide upon all matters which could properly have been disposed of at the meeting from which the adjournment took place if a quorum had been present.

The chairman.

The chairman of the board shall preside as chairman at every general meeting of the company.

Chairman not present.

If there be no such chairman or if at any meeting he shall not be present within 30 minutes after the time appointed for holding such a meeting or shall decline to take or shall retire from the chair the directors present shall choose some one of their number to be the chairman of the meeting and if no director is present or if all the directors present decline to take the chair the members shall choose some one of their number to be chairman.

Adjournment.

The chairman may, with the consent of the meeting, adjourn any meeting from time to time and from place to place but no business shall be transacted at any adjourned meeting other than the business left unfinished at the meeting from which the adjournment took place.

Resolution by show of hands.

At every general meeting all questions shall be determined immediately in the first instance by show of hands.

Declaration of chairman.

A declaration by the chairman of any general meeting that a resolution has been carried thereat upon a show of hands shall be conclusive and an entry to that effect in the book of proceedings of the company shall be sufficient evidence of the fact without proof of the number or proportion of the votes recorded in favour of or against such resolution, but if on such declaration being made a poll be demanded by not less than five members present in person or by proxy or the chairman of the meeting or any member or members holding not less than one-tenth of the issued capital which carries

voting rights shall be entitled to demand a poll and such demand being made the same shall be taken accordingly.

How poll to be taken.

If a poll is demanded in the manner aforesaid, it shall be taken at such time and place as the chairman of the meeting may direct, and either atonce or after an interval or adjournment or otherwise and the result of such poll shall be deemed to be the resolution of the company but the demand of a poll shall not prevent the continuance of a meeting for the transaction of any business other than the question on which a poll has been demanded. The chairman of the meeting shall either himself act as scrutineer or appoint one or more member or members to act as scrutineer or scrutineers.

Casting vote.

In the case of an equality of votes upon any question at any meeting the chairman of the meeting shall both on the show of hands and at the poll, be entitled to a casting vote in addition to his own vote or votes as a member.

PROCEEDINGS AT THE GENERAL MEETINGS

Minutes of General Meeting

At general meetings the rules applying to minutes are the same as for meetings of directors or managers. The minutes of general meeting must also be signed by the chairman of that meeting or the next succeeding meeting. In the case of joint stock companies, the rule which generally prevails is that the minutes are read and signed by the chairman at the next ensuing directors' meeting. If they are not so read or signed then it would be necessary to read the minutes at the next general meeting of the preceding general meeting and then to pass and sign same as a correct record. It was held as early as 1864 that the minutes once passed are considered as *prima facie* a correct record and the burden of proof is thrown on those who are attempting to challenge them (*Ex parte, Stock,* (1864) 33 *L. J. Ch.* 731). The usual habit of stating that the minutes

are "read and confirmed" is not accurate in connection with the passing of the minutes. The correct form should be "the minutes of the last general meeting held on 25th July, 1937, were signed as correct record." This is because the minutes, when passed, are simply verified accepted as a correct record of what occurred at the preceding meeting. There is nothing to confirm.

Here too the secretary of the company prepares an agenda, which is the list showing what business is to be transacted, and places same before the chairman who deals with the various items on this agenda in proper order. There are cases where regular agenda books are kept for the use of the chairman and secretary, both for directors' as well as shareholders' meetings, so that they are maintained for future reference in proper order. There are occasions where a matter is debated once again which was already debated at the previous meeting. In such cases this fact must be brought on record in the form of a separate minute. In case of error in writing of the minute book the pages should not be torn, but a line may be drawn across the matter which is sought to be cancelled. This is absolutely necessary because the minute book is a book of very great evidential value, and if a matter has to be proved in a Court of Law to have taken place, a torn minute book would be a very poor document for that purpose. In this connection a case came up before the English High Court as to whether a minute book in form of loose leaf arrangement would satisfy the requirements of the Act. It was held where minutes of directors' meeting of a company consisting of a number of loose leaves fastened together in two covers were tendered in evidence as a book within the meeting of S. 120 of the English Act of 1929 (our corresponding S. 83) that the document being in form in which it was possible to take something out or to put something in was not a book under S. 120 of the Act. (*Hearts of Oak Assurance Co., Ltd.* v. *James F. Flaver & Sons*, (1935) *W. N.* 164; (1936) 1 *Ch.* 76). Besides writing the minutes as accurately as possible, the secretary should see that he

keeps as full a record of the proceedings as circumstances will permit, so that, there may not be any room for doubt or they may not be construed into a different meaning. We have dealt fully with this question in connection with the minutes of the directors' meeting to which reference may be made.

Notices of General Meetings

We have already seen that a general meeting of a joint stock company is called either by the board of directors or on requisition of shareholders. The Sec. 78, which gives powers to the shareholders to requisition a meeting, runs as follows :—

(1) Notwithstanding anything in the articles, the directors of a company which has a share capital shall, on the requisition of the holders of not less than one-tenth of the issued share capital of the company upon which all calls or other sums then due have been paid, forthwith proceed to call an extraordinary general meeting of the company.

(2) The requisition must state the objects of the meeting, and must be signed by the requisitionists and deposited at the registered office of the company, and may consist of several documents in like form, each signed by one or more requisitionists.

(3) If the directors do not proceed within twenty-one days from the date or the requisition being so deposited to cause a meeting to be called, the requisitionists, or a majority of them in value, may themselves call the meeting, but in either case any meeting so called shall be held within three months from the date of the deposit of the requisition.

(4) Any meeting called under this section by the requisitionists shall be called in the same manner, as nearly as possible, as that in which meetings are to be called by directors.

(5) *Any reasonable expenses incurred by the requisitionists by reason of the failure of the directors duly to convene a meeting shall be repaid to the requisitionists by the company, and any sum so repaid shall be retained by the company out of any sums due or to become due from the company by way of fees or other remuneration for their services to such of the directors as were in default.*

This section overrides any special articles of the company concerned may be inconsistent therewith. The articles

may, however, allow holders of less than one-tenth of the issued share capital of the company to requisition a meeting and for that reason are not inconsistent and thus quite effective. The requisition must state the objects of the meeting and must be signed by the requisitionists and must be deposited at the registered office of the company. The documents constituting the requisition must be substantially the same but need not be identical (*Fruit & Vegetable Growers' Association Ltd.* v. *Kekewich,* (1912) 2 *Ch.* 52). The shareholders may include preference shareholders as well as holders of share warrants even though these shareholders may not have a right of voting. If joint holders sign the requisition they must all sign unless the articles provide otherwise (*Patent Wood Keg Syndicate* v. *Pearse,* (1906) *W. N.* 164). The requisition, of course, should be in accordance with the section, otherwise the meetings and resolutions passed thereat are invalid (*See Oriental Navigation Co.* v. *Bhanaram,* (1922) 49 *Cal.* 399 *at p.* 419). The directors must call the meeting within twenty-one days of the requisition, failing which the requisitionists or a majority of them in value, may call a meeting which must be held within three months of the date of the deposit of the requisition. *The new addition to the section by the Indian Companies (Amendment) Act, 1936, provides for reasonable expenses of the requisitionists being paid by the company and also empowers the company to recover same from the defaulting directors from their remuneration or fee that may be due to them.*

With reference to the notice the following points should be remembered :—

1. The notices must be given as provided for either in the act or by the regulations of the company, say, articles of association.

2. The general meeting must be convened by a resolution of the board of directors or by the members according to the provision of Sec. 79 (2).

3. All persons who have a right to receive such a notice must be served with such notice.

4. The notice must state with clearness the nature of the business which is to be done at the meeting.

5. The notice must be absolute and not conditional, because unless the articles permit conditional notices, they cannot be given.

6. The notice must provide for a convenient time and place for the meeting.

7. In case of notices of extraordinary meetings where extraordinary resolutions are to be passed, the fact that the resolution is to be an extraordinary resolution must be clearly stated.

8. The notices once given cannot be withdrawn but the correct procedure will be to hold the meeting and adjourn same.

9. Notices of adjourned meeting need not be given unless articles require same to be given.

As we have seen in the set of articles already quoted above the articles of association generally provide for the notices being given and for that purpose lay down the time. Usually fourteen days' notice is now provided for by these regulations for general meetings unless where the Act specifies a more lengthy period. We have already seen that seven or fourteen days' notice means so many clear days (*Mercantile Investment Co.* v. *International Co., of Mexico,* (1893) 1 *Ch.* 484). The object for which a notice has to be given is to see that a sufficiently full and frank disclosure is made to the shareholders of the facts upon which they were asked to vote and unless that is done the resolution passed at a meeting with such an insufficient notice are invalid and not binding on the company (*Baillie* v. *Oriental Telephone and Electric Co., Ltd.,* (1915) 1 *Ch.* 503). If all the members or shareholders of the company were present and assented to the waiver of the notice the position would be different (*Parker & Cooper* v. *Reading,* (1926) 1 *Ch.* 975; *Express Engineering Co.,* (1920) 1 *Ch.* 466). The fixing of the date and time as well as the place of meeting is no doubt in the entire discretion of the directors, with which the Court generally hesitates to interfere except where the Court is satisfied that an attempt is made to hold the annual general meeting on a particular date for the purpose of preventing shareholders from exercising their voting powers (*Cannon* v. *Trask,* (1875) *L. R.* 20 *Eq.* 669). We have already seen that where there is a deadlock and the board is unable to

act, a meeting of the shareholders can be called under Sec. 79. The address at which the notice should be sent or forwarded is the address of the member as entered in the register of members. In this connection it has been held that when the articles of association require the notice to be sent by post it need not be sent by post it need not be sent to the literal address as in the register of members, but substantial accurate designation of the address or place is sufficient (*Liverpool Marine Insurance Co.* v. *Houghton*, (1875) 23 *W. R.* 93). When the articles lay down as the general rule that the directors may send the notice, it means that the notice is sent by the duly authorised agent of the board of directors on behalf of the board, and the notice given by a similar director without such authority of the board will not be sufficient (*Browne* v. *La Trinidad*, (1887) 37 *Ch. D.* 1, *at p.* 17). The secretary, no doubt is usually the duly accredited agent of the board and sends notices of meetings under orders of the board. If the secretary convenes a general meeting without authority from the board but afterwards the board ratifies same before the date of the meeting the ratification will be sufficient (*Hooper* v. *Kerr, Stuart & Co.*, (1900) 83 *L. T.* 729). It thus becomes necessary for the secretary to get a proper resolution passed by the board at a meeting where a quorum is present, and get necessary authority in order to call a general meeting which will be valid. If *de facto* directors call a meeting, the meeting will be good in spite of the irregularity in the constitution of the board (*Boschoek Proprietary Co.* v. *Fuke*, (1906) 1 *Ch.* 148). Even where the notice was rather too short, or by the notice meeting was called where there was no quorum, the irregularity has been overlooked by the Court where immediate objection was not taken (*Browne* v. *La Trinidad*, (1887) 37 *Ch. D.* 1; *Southern Counties Deposit Bank* v. *Rider & Kirkwood*, (1895) 73 *L. T.* 374). The alteration of the articles, no doubt, has to be made by a special resolution, but where an article is regularly framed, and is adopted and acquiesced for a long time it may be

treated as valid and operative and as having been adopted by the shareholders. This was decided by *Lord Davey* in a Privy Council judgment in *Ho Tung* v. *Man On Insurance Co. Ltd.*, (1902) *A. C.* 232, where the learned judge on page 235 states as follows :—

"It appears, therefore, that these articles have been registered, and have been published and put forward as the company's only articles of association, and have been acted on, amended, and added to by the shareholders of the company, and the company's business has been conducted under the regulations contained therein for nineteen years without any objection, and the company on the record says that these articles are its articles of association. Their Lordships think that in these circumstances they are entitled to draw the inference that all the shareholders have accepted and adopted the articles as the valid and operative articles of association of the company. The articles of association stand on a very different footing from the memorandum, and are in the power of the shareholders themselves. The apparent object of requiring the articles to be signed before registration is to secure the adhesion of the only members of the company at that time to the regulations contained therein. It was no doubt as imperative for the registrar to require the articles to be signed before registering them as it was to see that they complied with the other requisitions of the ordinance, as, for example, that they were printed and expressed in paragraphs numbered arithmetically. But there is no reason why the shareholders should not adopt them although irregularly registered. The statutory mode of doing so is by special resolution; but this again is only machinery for securing the assent of the shareholders, or a sufficient majority of them. In the *Phosphate of Lime Co.* v. *Green,* (1871) *L. R.* 7 *Ch. p.* 43, it was held that the company was bound by the acquiescence of the shareholders in an act done by the directors in direct violation of the articles of association, although there had been no alteration of the articles by a special resolution."

Notice to be given to all entitled

The articles of almost every modern company clearly lay down details as to the class of shareholders who are entitled to be present at the meeting and vote and to whom notice is to be given. At the same time it is generally made clear that those beyond a certain area may not be given notice such as outside British India or outside India itself. Such articles are certainly very desirable. However,

even under the old common law every one entitled to attend at a meeting must be summoned by notice except those beyond summoning distance in order to make proceedings at the meeting legal and binding (*Smyth* v. *Darley*, (1849) 2 *H. L. C.* 789). The articles also provide that accidental omission will not invalidate meeting or that if a notice is posted at the registered address and is not received the same must be excused. This is also a very practical and necessary regulation. The articles also provide that certain classes of members such as preferential shareholders who have no right to vote shall not be entitled to get the notice, also that those who are in arrears with their calls are not entitled to notice and in some cases again they go so far as to lay down that only those holding minimum number of shares shall be entitled to get the notice and to attend. Such articles are valid and binding though they may be considered by some as unreasonable. If there is no article to the contrary, every shareholder must get a notice of meeting and has a right to attend same even though he may not have a right to vote. We have seen that executors and administrators of deceased shareholders are not entitled to get notice of a meeting, and if they wish to have same they must get themselves registered as members by transferring shares to their own name (*Allen* v. *Gold Reefs of West Africa*, (1900) 1 *Ch.* 656). In one case it has been decided however, that preference shareholders will have no right of voting or have no right to receive notice of a meeting (*Re. Mackenzie*, (1916) 2 *Ch.* 450). If the resolution which is proposed to be passed at a meeting of which the notice is given, alters the articles of association it is not necessary to say so precisely (though it is desirable that it should be done) because every shareholder is taken to have knowledge of the contents of the articles of his company (*Campbell's Case*, (1873) 9 *Ch.* 1.). But of course the new step which is proposed to be taken must be clearly stated in a notice (*Lawes' Case*, (1852) 1 *De G. M. & G.* 421). A notice of a meeting which is called to sanction an agreement for the sale of the assets of the

company will not be sufficient if it does not give the special advantages it offers to the directors from such a sale but only gives other particulars as to agreement. This is because there are two important items here and only one of them is stated (*Kaye* v. *Croydon Tramways,* (1898) 1 *Ch.* 358; *Tiessen* v. *Henderson,* (1899) 1 *Ch.* 861; *Clarkson* v. *Davies,* (1923) *A. C.* 100). It has been also held that where by the alteration of the articles it is proposed to increase the remuneration of the directors, that fact of increase of remuneration should be clearly stated in the notice (*Baillie* v. *Oriental Telephone and Electric Co.,* (1915) 1 *Ch.* 503). Attempts have been made to indicate the new articles in the notice without stating what alteration the new articles seek to effect may not be considered sufficient by the Court as notice to the shareholders of the proposed alteration (*Normandy* v. *Ind. Coope & Co.,* (1908) 1 *Ch.* 84). It is also necessary under the Indian Companies Act of 1913 that where the company was to decide in a meeting whether it should go into winding up by reason of its liability, the said fact must be stated in the notice (*As in Stone* v. *City and County Bank,* (1878) 3 *C. P. D.* 282; *Bridport Old Brewery,* (1867) 2 *Ch.* 191). Where a meeting is called to consider reconstruction of the company under Sec. 213 of the Indian Companies Act of 1913, the notice of the meeting must specify the section under which the same is sought to be done (*Etheridge* v. *Central Uruguay Northern Extension Rly.,* (1913) 1 *Ch.* 425; *Irrigation Company of France, re. Fox Ex-part,* (1871) 6 *Ch.* 176). We have, of course, seen that in case of extraordinary resolution to be passed as an extraordinary resolution the notice must set out the exact resolution. It is held that no amendment to an extraordinary resolution can be accepted. It is, of course, not competent to any meeting to drop a resolution which has been notified and substitute another resolution which is of such a nature that special notice should have been given of it (*Indian Zoedone Co.,* (1884) 26 *Ch. D.* 70). Of course failure to give notice to a single shareholder would, unless otherwise provided for by

the articles as is usually done, invalidate the meeting (*British Sugar Refining Co.*, (1857) 3 *K. & J.* 408). If there is no special provision notice by advertisement has been held to be sufficient (*Mercantile Investment Co.* v. *International Co.*, (1893) 1 *Ch.* 484). It is quite possible to do special business at the ordinary meeting provided proper notice is given (*Graham* v. *Van Diemen's Land Co.*, (1856) 26 *L. J. Ex.* 73). If the special business is not stated in connection with the notice of general meeting, only the general business will hold good, and anything done in connection with special business will be invalid (*Lawes' Case*, (1852) 1 *De G. M. & G.* 421). It must be noted that the invalidity of the meeting does not affect outsiders who are dealing with the company and who have no knowledge of the invalidity (*Royal British Bank* v. *Turquand*, (1856) 6 *E. & B.* 327; *Irwin* v. *Union Bank of Australia*, (1877) 2 *A. C.* 266). The act done at an invalid meeting can, of course, be ratified by a subsequent meeting held in a reasonable time of the date of the invalid meeting (*Re. Portuguese Copper Mines*, (1889) 42 *Ch. D.* 160). The notice of course must be signed by properly authorised parties such as the secretary or director or other officer of the company, though, it need not be under the common seal of the company. The signature of the person signing may be either personal signature or it may be by some agent authorised by them in writing (*Re. Whitley Partners, In re. Callan's Case*, (1886) 32 *Ch. D.* 337).

Generally speaking the resolution passed at a meeting need not be in the identical terms of that specified in the notice. All that is required by law is that it should substantially cover the subject-matter as indicated by the resolution in the notice (*Torbock* v. *Lord Westbury*, (1902) 2 *Ch.* 871). Where the articles lay down the rules as to notices, usually all that is required is that they should be substantially complied with (*In re. British Sugar Refining Co.*, (1857) 3 *K. & J.* 408). This is because in law the notices will not be construed with excessive strictness (*Wright's Case*, (1871) 12 *Eq.* 331; *Grant* v. *United*

Kingdom S. Ry. Co., (1888) 40 *Ch. D.* 135). The rule of general application is that notices should be construed as business men would understand them (*Alexander* v. *Simpson,* (1889) 43 *Ch. D.* 139). But of course the simple expression 'special business' will not do in a notice, particularly when convening an extraordinary meeting (*Wills* v. *Murray,* (1850) 4 *Exch. Reps.* 843). In one case where the notice stated that a remuneration was to be allowed to the directors without giving the actual amount, and when as a matter of fact a large amount was to be payable, that information was not considered sufficient (*Baillie* v. *Oriental Telephone & Electric Co.,* (1915) 1 *Ch.* 503). Even where it was stated in a notice that the capital would be increased without stating to what amount it was to be so increased, the information was held to be insufficient (*McConnell* v. *E. Prill & Co.,* (1916) 2 *Ch.* 57). In one case where notice was given of a particular resolution being considered and a particular scheme being adopted, and at the meeting a part only of it was adopted, this adoption of the part was held not to be justifiable on the ground that shareholders might have abstained from attending the meeting as they were perhaps satisfied with the originally suggested course (*Clinch* v. *Financial Corporation,* (1868) 5 *Eq.* 450). When a contract in which the directors are personally interested is to be considered at a meeting, the notice should give particulars as to such interest of the directors (*Kaye* v. *Croydon Tramway Co.,* (1898) 1 *Ch.* 358; *Normandy* v. *Ind. Coope & Co.,* (1908) 1 *Ch.* 84). The notice must be conclusive about the meeting being held because a notice in the form that in a certain contingency the meeting will be held is not considered to be a notice (*Alexander* v. *Simpson,* (1889) 43 *Ch. D.* 139).

THE USUAL BUSINESS AT ANNUAL GENERAL MEETINGS

The general meetings held annually as required by the Indian Companies Act of 1913 (Sec. 64) do the usual

stereotyped business which is generally laid down in the articles of association of every company. The specific business laid down is, receiving of directors' report together with *a profit and loss account, or a revenue and expenditure in case of a non-trading company* and the balance sheet, passing of resolutions as to the payment of dividends from the balance of profit declared available for the purpose by the directors, re-election of directors who have died, or resigned or retired by rotation, appointment of the auditors for the year to come and fixing of their remuneration. All other business will be considered as special and which must be transacted at an extraordinary general meeting or if the same has to be done at this meeting a special notice has to be given. The usual practice is to do the special business at an extraordinary meeting specially convened, and if it is thought convenient to do this special business on the same day as the date of the annual general meeting. The practice is to notify that "soon after the conclusion of the business of the annual general meeting in extraordinary general meeting will be held where the following business will be done." Thus two types of meetings can be held under this arrangement on the same day and under the same notice.

Extraordinary General Meeting

It will be seen that extraordinary general meetings are convened for the purpose of doing any special business which cannot be transacted at an ordinary annual general meeting. These extraordinary meetings can be convened by the board of directors if they so desire or as we have seen above, under Sec. 78 by requisition of shareholders holding not less than one-tenth of the share capital of the company. The usual articles to be found in our Indian Companies in connection with these extraordinary meetings are already given under the heading "general meetings" to which reference may be made if necessary.

FORM OF NOTICE FOR CONVENING AN ANNUAL GENERAL MEETING

THE PROSPECTIVE MANUFACTURING CO., LTD.

NOTICE

The tenth ordinary general meeting of the shareholders of the company will be held on Monday, 12th January, 1937 at 4 p.m. (S. T.) at the registered office of the company, 85, Esplanade Road, Bombay to transact the following business :—

1. To receive and adopt the directors' report and audited balance sheet for the year ended 31st December, 1937.
2. To elect two directors in place of Sir Saklatwala, Kt., and Mr. R. N. Manekji who retire by rotation, but are eligible for re-election.
3. To appoint auditors for the current year, and fix their remuneration.
4. To transact such other business as may be brought forward.

The transfer books of the company have been closed from Saturday, the 23rd December, 1937 and will remain closed up to Monday, the 2nd January, 1937, both days inclusive.

By Order of the Board of Directors.
The Prospective Manufacturing Co., Ltd.

K. N. PETTIT,
Secretary.

Bombay, 25th December, 1937.

FORM OF NOTICE FOR CONVENING AN EXTRAORDINARY GENERAL MEETING

THE PROGRESSIVE MANUFACTURING CO., LTD.

NOTICE is hereby given that an extraordinary general meeting of the members of this company will be held at 85, Esplanade Road, Bombay, on Monday, 12th January, 1937 at 3 o'clock in the afternoon, when the subjoined resolution will be submitted to the meeting to be passed in the manner required for the passing of a special resolution :—

That in pursuance of the recommendation of the committee of investigation appointed at the extraordinary general meeting held on the 12th December, 1937, the ordinary share capital of the company be reduced from Rs. 1,00,00,000 to Rs. 50,00,000 by writing down each fully paid ten rupees ordinary share to the

value of five rupees fully paid, and that a petition be made to the Court for an order confirming the reduction.

By Order of the Board,
K. N. PETTIT,
Secretary.

Bombay, 25th December, 1937.

FORM OF NOTICE CONVENING MEETING ON REQUISITION

THE PROSPECTIVE MANUFACTURING CO., LTD.

NOTICE is hereby given that in accordance with the requisition deposited by the shareholders of the above company under powers conferred on them by Sec. 78 of the Indian Companies Act, 1913 an extraordinary general meeting will be held on 20th January, 1937 at 5 p.m. (S. T.) at 85, Esplanade Road, Bombay, when the following resolution will be submitted to the meeting to be passed in the manner required for passing a special resolution :—

(Set out the resolution).

By Order of the Board,
K. N. PETTIT,
Secretary.

Bombay, 12th January, 1937.

When the company has issued share warrants and the holders of share warrants are also entitled to attend and vote at the meeting, the notice also includes a paragraph in more or less the following form :—

THE PROSPECTIVE MANUFACTURING CO., LTD.

The holders of share warrants in the above company who are desirous of attending the aforesaid meeting are reminded that according to the requirements of the articles of association they must deposit their warrants together with a statement in writing of their names and addresses with the secretary of the company at its registered office at 85, Esplanade Road, Bombay, four clear days before the date fixed for the meeting. On such deposit the depositors will receive a certificate of deposit and a ticket of admission to the meeting. The warrants shall be returned to the depositors the day after the meeting is held on their surrendering the certificates of deposit.

By Order of the Board,
K. N. PETTIT,
Secretary.

Bombay, 12th January, 1937.

When the company has issued share warrants and the holders of share warrants are also entitled to attend and vote at the meeting the notice also includes a paragraph in more or less the following form :—

THE PROSPECTIVE MANUFACTURING CO., LTD.

The holders of share warrants in the above company who are desirous of attending the aforesaid meeting are reminded that according to the requirements of the articles of association they must deposit their warrants together with a statement in writing of their names and addresses with the secretary of the company at its registered office at 85, Esplanade Road, Bombay, four clear days before the date fixed for the meeting. On such deposit the depositor will receive a certificate of deposit and a ticket of admission to the meeting. The warrants shall be returned to the depositors the day after the meeting is held on their surrendering the certificates of deposit.

By Order of the Board,

K. N. PETTIT,

Secretary.

Bombay, 12th January, 1937.

RESOLUTIONS AND VOTING

Annual General Meeting

As we have already seen it is usual in a joint stock company that the chairman of the company takes the chair as of right at all general meetings and when he is absent some other director takes the chair. If no director is willing to take the chair, the meeting can appoint its own chairman from amongst the members present, as an outsider cannot be the chairman of a meeting of members of a joint stock company (*Blair Open Hearth Furnace Co.* v. *Reigart,* (1913) 108 *L. T.* 665). The usual practice in all meetings happens to be for the chairman to introduce the report, or the subject matter of the meeting, by an opening speech at the conclusion of which he moves the adoption of the report if the meeting is an annual general meeting, met to consider the report and accounts as prepared and presented by the directors to the shareholders. At this annual meeting, if the shareholders are dissatisfied with the

report and accounts, they can reject the report by refusing to pass the resolution and the usual practice is for them to move a resolution to appoint a committee of inspection either by an amendment, or by an original resolution. The form of the resolution for rejecting the report and the appointment of a committee of inspection is as follows :—

"That the report and accounts be received but not adopted."

Where it is desired that a portion of the report be rejected, the proposition will be moved as follows :—

"That the report and accounts be received and adopted except (here state the exception)."

Where it is also intended to appoint a committee of inspection the following paragraph will be added to the resolution :—

"That a committee made up of Messrs. X, Y, & Z, shareholders of this company be and is appointed to investigate the affairs of this company and to submit a report within one month from this date as to the results of their investigations. That this meeting stands adjourned to 1st March, 1937 with a view to receive the said report at 4 p.m. (S. T.) on 1st March, 1937 at the same place."

This committee, however, formed in order to investigate will have very limited powers unless the directors are willing to give facility and information. The correct and more efficacious method of getting affairs of the company inspected is through inspectors appointed under Sec. 142 of the Companies Act. This section empowers the shareholders on their own motion by a special resolution to appoint inspectors for examining the affairs and accounts of the company and reporting on them. The section lays down as follows :—

Sec. 142 (1) A company may, by special resolution, appoint inspectors to investigate its affairs.

(2) Inspectors so appointed shall have the same powers and duties as inspectors appointed by the local government, except that, instead of reporting to the local government, they shall

report in such manner and to such persons as the company in general meeting may direct.

(3) All persons who are or have been officers of the company shall incur the like penalties in cases of refusal to produce any book or document required to be produced to inspectors so appointed, or to answer any question, as they would have incurred if the inspectors had been appointed by the local government.

Other sections also relevant where the local government appoint inspectors, on application of members or shareholders, are the following :—

Sec. 138. The local government may appoint one or more competent inspectors to investigate the affairs of any company and to report thereon in such manner as the local government may direct :—

(*i*) in the case of a banking company having a share capital, on the application of members holding not less than one-fifth of the shares issued;

(*ii*) in the case of any other company having a share capital, on the application of members holding not less than one-tenth of the shares issued;

(*iii*) in the case of a company not having a share capital, on the application of not less than one-fifth in number of the persons on the company's register of members;

(*iv*) in the case of any company, on a report by the registrar under Sec. 137, sub-section (5).

Sec. 139. An application by members of a company under Sec. 138 shall be supported by such evidence as the local government may require for the purposes of showing that the applicants have good reason for, and are not actuated by malicious motives in, requiring the investigation; and the local government may, before appointing an inspector, require the applicants to give security for payment of the costs of the inquiry.

Sec. 140. (1) It shall be the duty of all persons who are or have been officers of the company to produce to the inspectors all books and documents in their custody or power relating to the company.

(2) An inspector may examine on oath any such person in relation to its business, and may administer an oath accordingly.

(3) If any person refuses to produce any book or document which under this section it is his duty to produce, or to answer any question relating to the affairs of the company, he shall be liable to a fine not exceeding fifty rupees in respect of each offence.

Sec. 141. (1) On the conclusion of the investigation, the

inspector shall report their opinion to the local government, and a copy of the report shall be forwarded by the local government to the registered office of the company, and a further copy shall, at the request of the applicants for investigation, be delivered to them.

(2) The report shall be written or printed, as the local government directs.

(3) All expenses of, and incidental to, the investigation shall be defrayed by the applicants unless the local government directs the same to be paid by the company, which the local government is hereby authorised to do.

Provided that the expenses of, and incidental to, an investigation held in pursuance of Clause (IV) of Sec. 138 shall be paid out of the assets of the company and shall be recoverable as an arrear of land revenue.

(4) *The registrar shall keep the copy of the report sent to him with the records of the company in his custody.*

If however the report is passed, the subsequent business is taken on hand. The chairman's duty is to see that every one present is given a fair opportunity to be heard on every question before the meeting (*Wall* v. *London & Northern Assets Corporation No.* 1, (1898) 2 *Ch.* 469), and that none but the mover of the proposition is allowed a second speech, except by way of a brief explanation. When the discussion is finished the chairman generally rises to speak with a view to meet the criticism and answer questions that may have been raised in the course of the discussion. The next business at this annual general meeting is to declare a dividend in accordance with the recommendation of the directors. This may be done after either adopting or rejecting the directors' report. The meeting generally closes with a vote of thanks to the chair.

Extraordinary General Meeting

In cases of extraordinary or special general meetings, the procedure as to the putting of resolutions, seconding them, voting, demands for polls and proxy is the same as in the case of annual general meetings. As these meetings are specially convened to consider some particular question which has been notified, the chairman opens the proceedings,

after the notice convening the meeting has been read by the secretary with an explanatory speech in the course of which he gives reasons which led to the meeting being called and speaks on the merit of the proportion before the meeting. After this the resolution is generally moved in due form and seconded. Amendments, if any, of which due notice has been given if required by the articles, or which arise naturally from the original proposition being relevant to it may be moved and dealt with in the usual form. The amendments have to be relevant to the original motion and supposing that a meeting is called with a view to pass a resolution for reconstruction, and an amendment is passed resolving that the company should be wound up, this would not be in order (*Teede and Bishop Ltd.,* (1901) *W. N.* 52). This is because the shareholder, when he receives a notice and sees that a particular thing is going to be done, naturally may not attend if he sees no objection to it, but if he had known that winding up was to be considered he may have attended to express his views and to oppose the amendment.

Chairman's Duties

The chairman has to put all motions, or resolutions, and amendments correctly brought forward, to the vote, and it is he who declares the result. The chairman has the common law right to enforce order, and if a person present behaves in a disorderly manner, the chairman after giving him proper opportunity to correct his conduct, or to withdraw, may order him to be forcibly ejected. In case of ejection, no more force should be used than is actually necessary. When the chairman finds it impossible to maintain order, he has a right to adjourn the meeting. This right to adjourn the meeting under normal circumstances depends on the constitution of the company, which has to be carefully consulted, as in absence of express powers, the chairman cannot adjourn the meeting without the consent of the members present. The chairman decides all points of order raised by any

member present and his ruling on points of procedure is final. It was held in *Henderson* v. *Bank of Australasia*, (1888) 40 *Ch. D.* 170, that when a chairman deliberately rules that a certain amendment cannot be moved, it would be improper and indecent for any member to proceed to discuss the propriety of the chairman's ruling.

In *National Dwellings Society* v. *Sykes*, (1894) 3 *Ch. D.* 159, it was laid down that the duty of the chairman was to preserve order, conduct proceedings regularly, and to take care that the sense of the meeting is properly ascertained with regard to any question before it, but he has no power to stop the meeting, or adjourn it, unless the articles give him the power. If the articles lay down that the chairman " may " adjourn, as in Table A, he has a discretion and may decline to adjourn even though the majority of shareholders desire the adjournment (*Salisbury Gold Mining Co.* v. *Hathorn,* (1897) *App. Cases* 268). If he wrongfully does so the meeting can go on by appointing another chairman. The latest case in point is *Wall* v. *Exchange Investments Corporation Ltd.*, (1926) 1 *Ch.* 143, where the articles laid down that no objection should be taken to the validity of any vote except at the meeting at which it was tendered and that every vote whether given in person or proxy, not disallowed at any meeting should be valid for all purposes. It was also held that the decision of the chairman who in *bona fide* exercise of the power conferred upon him by the articles, had refused to disallow a vote by proxy to which objections had been taken at the meeting was final and would not be reviewed by the Court (*Wall* v. *London and Northern Assets Corporation No.* 2 (1899) 1 *Ch. D.* 550).

SPECIAL TYPES OF RESOLUTIONS

The resolutions that can be passed at the meetings held by a joint stock company may be divided under three different headings, *viz.*, (1) ordinary resolution, (2) extraordinary resolution and (3) special resolution.

An ordinary resolution, is one passed by the majority

of such members as are entitled to vote, who are present in person or by proxy. An extraordinary resolution, is a resolution, passed by a majority of not less than three-fourths of such members as are entitled to vote, and who are present, either personally or by proxy (where proxies are allowed), at a general meeting of which due notice, specifying the intention to propose the said resolution as an extraordinary resolution, has been duly given [Sec. 81 (1)]. A resolution shall be a special resolution when it has been passed by such a majority as is required for the passing of an extraordinary resolution and *at a general meeting of which not less than twenty-one days' notice specifying the intention to propose the resolution as a special resolution has been duly given. If however all the members entitled to attend and vote at any such meeting so agree, a resolution may be proposed and passed as a special resolution at a meeting of which less than twenty-one days' notice has been given [81 (2)]*. These special resolutions are generally necessary when (1) the articles of the company are to be altered, or where, (2) the memorandum has to be altered after due leave of the Court as may be necessary under law, or (3) to alter the name of the company with the consent of the local government or (4) for effecting a reduction in the capital of the company, or (5) for sub-division of the same. It is not compulsory for a special resolution to be passed in the exact terms of the notice, and it may be amended at the meeting (*Torbock* v. *Lord Westbury*, (1902) 2 *Ch. D.* 871). After special and extraordinary resolutions have been passed according to Sec. 82 of the Indian Companies Act 1913, a copy of the resolution must be printed or typewritten and filed with the registrar within fifteen days from the passing of the resolution.

When convening a meeting for passing an extraordinary resolution, the notice must specify the intention to propose the resolution as an extraordinary resolution. The form of the wording used is that the meeting is 'convened to consider and, if thought fit, pass the following

resolution, which will be proposed as an extraordinary resolution' (*McConnell* v. *E. Prill & Co.*, (1911) 2 *Ch.* 57). If these words are by any chance omitted, the resolution will be irregular and void unless all the shareholders happen to be present and waive this omission in the notice, as may happen in case of private limited companies, where the limited number of shareholders belong to a partnership, or to a family holding all the shares (*Oxted Motor Co. Ltd.*, (1921) 3 *K. B.* 32).

The Casting Vote

Generally speaking, the chairman has two rights of votes, (*a*) that of voting in his capacity as a member according to the voting power reserved to individual members, and (*b*) in case of a tie, *i.e.*, where the votes are equal on either side, he has, what is known as the "casting vote," by the use of which, he may help the meeting to arrive at a decision, if he so desires. No discussion should be allowed until there is some duly proposed and seconded motion or proposition before the meeting, as otherwise, the meeting may continue talking of irrelevant matters without arriving at a decision.

HOW PROPOSITIONS ARE TO BE MOVED

When propositions are to be moved, of which due notice has been given, the chairman calls upon the proposer to move the proposition. This has to be seconded by some other member present. It may be here mentioned that when the articles of association make it compulsory that notice of business at a meeting of a special nature must be given, the notice must give substantial information as to what is proposed to be done otherwise the business done will be invalid (*Pacific Coast Coal Mine Ltd.* v. *Arbuthnot*, (1917) *App. Cases* 607).

The motion must always be framed in an affirmative form.

A motion which is not seconded has to be dropped and

no note will be taken of it in the minutes. On the other hand, when once the motion is proposed and seconded, it becomes the property of the meeting, and neither the proposer nor the seconder has the right to withdraw it without the unanimous consent of the meeting. The mover of a motion which is not seconded has no right to speak on it. After a motion is proposed and seconded, an amendment of which due notice has been given, may be moved. On all these points it has been decided that, where no notice as to amendment on a motion was given, if the amendment falls within the scope of the original notice, it may be moved (*Torbock* v. *Lord Westbury*, (1902) 2 *Ch.* 871). On the same principle, where notice of a meeting for the appointment of other persons as directors was duly given it was held that, it was within the rights of the parties to add more names by way of amendments. When more than one amendment of a motion is proposed, the chairman may use his discretion in arranging the order in which they are to be taken in hand. After dealing with the amendments, the original motion may be taken in hand, *i.e.*, if the amendments are lost, the original motion is put to the meeting, but if the amendment is carried, the original motion, as altered by the amendment, is taken up and put to the meeting as a "substantive motion." If the chairman refuses to put an amendment lawfully moved, the resolution of which it is the amendment, will be invalidated.

THE RIGHT OF SPEECH OF A MEMBER

As to the right of the shareholder to speak at a meeting *Pratt J., in Parshuram Dattaram Shamdasani* v. *The Tata Industrial Bank Ltd.,* (1923) 47 *Bom.* 915, laid down that "A shareholder is not entitled to speak as much as he pleases but has a right to be heard in reasonable terms for a reasonable time. "See also (*Wall* v. *London and Northern Assets Corporation, No.* 1, (1898) 2 *Ch. D.* 469). The other points of interest laid down in this decision of *Pratt, J.* were (1) where the articles lay down that the

chairman "may adjourn the meeting with the consent of the meeting" the chairman cannot be compelled to adjourn the meeting; (2) irregularities are not a matter for the Court, but for the majority of the company to deal with; (3) the Court will interfere only if the rights of the shareholders are infringed or if a case of fraud or *ultra vires* action is made out.

THE CLOSURE

It frequently happens that the discussion on any motion or amendment, drags on, in which case, if the constitution of the company permits, and any one present who thinks that the mind of the meeting is made up, and that the motion should now be put to the vote without any further waste of time, may propose that the "question be now put to the vote." If seconded, the chairman should put it to the vote, and if carried, no further discussion on the original proposition, or the amendment on which the closure was proposed, should be allowed. The question has to be put to the meeting immediately and the result announced. If however the motion for closure is lost, the discussion must proceed.

We have just seen above that every member of a company has a right to be heard for a reasonable time on the question at issue. On this point it was laid down in *Wall* v. *London Northern Assets Corporation, No.* 1, (1898) 2 *Ch. D.* 469 to the effect that "at the meeting of the corporation it is not competent to the majority to come determined to vote in a particular way on any question and to refuse to hear any arguments to the contrary; but when the views of the minority have been heard, it is competent to the chairman with the sanction of a vote of the meeting to declare the discussion closed and to put the question to vote." It was also held that it was irregular to move an amendment at a meeting held to confirm a resolution so as to make it a special resolution.

It may be further added that, a company which is a member of another company may, by resolution of the

directors, authorise any of its officials, or any other person, to act as its representative at any meeting of that other company, and the person so authorised shall be entitled to exercise the same powers on behalf of the company which he represents, as if he were an individual shareholder of that other company whose meeting he attends. (Sec. 80).

THE AMENDMENT AND MODE OF VOTING

On a resolution being moved and seconded, any one present may move an amendment on the resolution. The amendment is to amend the original resolution either by adding words, substituting words or omitting certain words. The amendment should not be in the negative form, because, if a person does not want the resolution to be passed he could carry out that object by asking those present to vote against it. The usual practice for the chairman is to ask the mover of the resolution, as well as the mover of the amendment, to put his amendment in writing, sign it, and then offer that paper to him so that there may not be any misunderstanding thereafter as to the actual wording that was used. The amendment must be relevant to the main question and within the scope of the meeting. It need not be seconded. The proposition put by the chairman himself from the chair also need not be seconded (*In Re. Horbury Bridge Co.*, (1879) 11 *Ch. D.* 109).

It should be however remembered that the rule as to the presentation of motions and amendments in writing, though usually followed voluntarily, cannot be enforced, and the chairman cannot refuse to submit a motion or amendment to vote simply because it has not been handed over to him in writing (*Henderson* v. *Bank of Australasia*, (1890) 45 *Ch. D.* 330).

It is the chairman's right to regulate the order in which members should speak. The usual practice, as well as the rules, generally lay down that the chairman should ascertain the sense of the meeting by a show of hands unless on declaration of the result by show of hands

a requisite number as provided for by the articles ask for a poll. The voting rights of members or shareholders in joint stock companies are determined by the articles of association. Usually each share carries one vote but there is nothing in law to prevent the company from giving one vote for five, ten or even a hundred shares by specific clauses in the articles of association. There are cases even where a certain class of shareholders such as preference shareholders may not be given any vote. It should be remembered that a right to vote is property and once the shareholder possesses that right, it will be protected by the Court (*Pender* v. *Lushington,* (1877) 6 *Ch. D.* 70; *Osborne* v. *Amalgamated Society of R. S.,* (1911) 1 *Ch.* 540). The company, of course, considers the shareholders on the register entitled to vote and when shares are held by trustees or mortgagees, the company cannot interfere if they vote as principals even against the wishes of the original shareholder although no interest is in arrear and the principal has not yet become payable (*Siemens Bros. & Co.* v. *Burns,* (1918) 2 *Ch.* 324). In short the register of shareholders or members is considered to be the only evidence of member's right to vote at a general meeting (*Pender* v. *Lushington,* (1877) 6 *Ch. D.* 70; *Wise* v. *Lansdell,* (1921) 1 *Ch.* 420). Where notices have been given of several resolutions, each of them must be placed before the meeting separately for consideration unless the meeting unanimously in favour of all the resolutions (*R. E. Jones,* (1933) 50 *T. L. R.* 31). In this case it was also decided that poll must be taken on all resolutions separately though all may be included in one sheet of paper to be marked by the others. Where the articles so provide, the chairman's decision as to whether a vote is valid or not will be conclusive if no fraud is proved (*Wall* v. *London & Northern Assets Corporation No.* 1, (1898) 2 *Ch.* 469). The right to vote may by contract be assigned to some other person and enforced by mandatory injunction (*Puddephatt* v. *Leith,* (1916) 1 *Ch.* 200, *Greenwell* v. *Porter,* (1902) 1 *Ch.* 530).

The right of holders of share warrants to vote depends upon the regulations of the company. In some cases the articles do not give them any voting power whereas in others the voting power is given. The articles usually provide that the warrants should be left at the office of the company for particular period prior to the date of the meeting. There is nothing in law to prevent members or shareholders from transferring or purchasing shares in the name of nominees with a view to increase their voting powers where there are restrictions in the articles limiting the number of votes to certain number of shares for laying down the maximum number of votes which a member could have irrespective of the large number of shares he may hold (*In re. Stranton Iron & Steel Co.*, (1873) 16 *Eq*. 559). An alien enemy however cannot vote (*Robson* v. *Premier Oil & Pipe Line Co.*, (1915) 2 *Ch*. 124). Questions have arisen as to whether shareholders can vote in case of class meetings against the interest of that class simply because the other class to which they also belong and of which they hold larger number of shares will benefit thereby. The Courts have always decided that they can do so, so long as they act without fraud (*British American Nickel Corporation* v. *M. J. O'Brien*, (1927) *A. C.* 369; *North West Transportation Co.* v. *Beatty*, (1887) 12 App. *Cases* 589; *Burland* v. *Earle*, (1902) *A. C.* 83, *on page* 94; *Dominion Cotton Mills* v. *Amyot*, (1912) *A. C.* 546). The Courts however have interfered where the directors and their friends, through shares issued by the directors themselves and their friends with a view to obtaining control of voting power have tried to pass resolutions by restraining their issue (*Punt* v. *Symons & Co.*, (1903) 2 *Ch*. 506). It is however held that an agreement made for a monetary consideration to vote for the advantage of another person in course of a winding up is void (*Elliot* v. *Richardson*, (1870) 5 *C. P.* 744). When there are joint holders, the articles usually provide as to how they should vote and these provisions must be strictly followed. These joint holders are entitled to have their names entered in any order they like.

THE POLL

The advantage of a poll is that whereas on a show of hands every person present has only one vote, in a poll the voting of each member is counted on the footing of the shares he or she holds according to the provisions of the articles of association and even the votes of the absent members can be recorded through their proxies. Every person who wishes to demand a poll must do so immediately on the declaration of the result by show of hands and before the next business is proceeded with. The articles of association of most companies contain regulations as to the demand for a poll which must be strictly followed. The chairman decides whether the poll has been properly demanded and if satisfied grants it. It is his discretion whether to take the poll immediately, as is frequently done, when the representative shareholders are present and the counting of votes can be conveniently done on the spot (*Chillington Iron Co.,* (1886) 29 *Ch. D.* 159). Of course the shareholder who has not voted at the meeting can vote on the poll. If the counting of the votes is likely to take time the chairman fixes the hours and dates during which the poll is to be held. Here he should fix the date and hour at which the poll closes because if he fails to do so he must take in votes as long as they come in (*Reg.* v. *St. Pancras,* (1839) 11 *A. & E.* 15). The chairman should not improperly exclude any voter as that would invalidate the poll (*Reg.* v. *Lambeth,* (1838) 8 *A. & E.* 356). The usual practice is for the chairman to appoint scrutineers to assist him in counting votes and these scrutineers are selected from both sides. If there is some irregularity in the appointment of scrutineers, this can be remedied later. It may be added that though scrutineers are desirable they are not necessary unless the articles expressly provide for their appointment (*Wandsworth & Putney Gas Co.* v. *Wright,* (1870) 22 *L. T.* 404). The only means of finding out whether there was a lawful meeting or a lawful demand for poll where scrutineers are appointed is the register of members or shareholders (*See Pender* v. *Lushington,* (1877) 6 *Ch. D.* 70).

With reference to the poll itself it should be remembered that the persons demanding the poll must be present in person (*R.* v. *Government Stock Investment Co.*, (1878) 3 *Q. B. D.* 443). When the demand for poll is challenged the chairman must justify the same (*Re. Phoenix Electric Light Co.*, (1883) 48 *L. T.* 260). Proxies lodged after the date of the original meeting, but before the adjourned meeting, are invalid (*McLaren* v. *Thomson*, (1917) 2 *Ch.* 261). Although, of course, if the articles of association permit this to be done the position would be different. In one case where a poll was granted and fixed to be taken at a future date, but the chairman did not adjourn the meeting, it was held that the meeting was adjourned only for the purpose of the poll and therefore continued for that purpose with the result that no fresh proxies could be taken (*Shaw* v. *Tati Concessions*, (1913) 1 *Ch.* 292). The chairman's declaration as to the result of voting is of course conclusive unless fraudulent (*Arnot* v. *United African Lands*, (1901) 1 *Ch.* 518; *Re. Caratal (New) Mines, Ltd.*, (1902) 2 *Ch.* 498). It is now laid down the " conclusive " in S. 117 (3) Indian S. 81 (3) means what it says conclusive and not *prima facie* evidence (*Re. Gold Co. In re.* (1879) 11 *Ch. D.* 701; *Hadleigh Castle Gold Co.*, (1900) 2 *Ch.* 419). Once the demand for a poll is made it is very doubtful whether it can be withdrawn without the consent of the meeting (*Rex* v. *Mayor of Dover*, (1903) 1 *K. B.* 668). If the articles lay down that a poll can be demanded by persons holding a specified number of shares two or more joint holders holding the necessary shares, can demand a poll (*Siemens Bros.* v. *Burns*, (1918) 2 *Ch.* 324). There are articles which say that the proxy if signed by a joint stock company shareholder must bear the seal of the company signing. Here if the company or corporation is a foreign company or corporation registered in a country where it need not possess a common seal the use of the common seal may be dispensed with (*Colonial Gold Reefs Ltd.* v. *Free State Rand*, (1914) 1 *Ch.* 382). No doubt the proxy can be cancelled at any time before the

person acts upon it, but if the articles provide that a notice of the revocation of the proxy must be received before the meeting it cannot be cancelled after the poll has been directed to be held (*Spiller* v. *Mayo* (*Rhodesia*) *Development Co. Ltd.,* (1926) *W. N.* 78, 126, *L. T. Jour.* 212). There is nothing wrong if directors acting *bona fide* in the interests of the company send out proxies with their own names inserted therein accompanied by circulars in which they advocate their policy at the expense of the company (*Peel* v. *London and North Western Railway,* (1907) 1 *Ch.* 5). If there are a number of resolutions dealt with in a meeting separate voting must be taken on each resolution because a vote taken together will be invalid (*Patent Wood Keg Syndicate* v. *Pearse,* (1906) *W. N.* 164).

PROXIES

There is no legal common law right of a member of a company to have his vote accepted by proxy (*Harben* v. *Phillips,* (1883) 23 *Ch. D.* 14). But the articles of association of almost all joint stock companies incorporate this right by proxy and if the form of the instrument of proxy is given in the articles that form alone should be used. It is provided generally that only a member can be appointed to act as a proxy and not an outsider. Here the proxy need only be a member on the date of the meeting even though he was not one at the date of his appointment (*Bombay Burma Trading Co.* v. *Shroff,* (1905) *App. Ca.* 213). A proxy may be appointed for a particular meeting, or the proxy may be general, to be used at a number of meetings. The importance here lies mainly in the amount of the stamp duty. If the instrument of proxy is stamped with an adhesive stamp, it should be cancelled preferably by the signature of the shareholder being written across the stamp or in any other manner so as to make the cancellation effective (*McMullen* v. *Sir Alfred Hickman Steamship Co. Ltd.,* (1902) 71 *L. J. Ch.* 766). The proxies must be filled in and dated before they are handed to the secretary because the present practice of issuing blank

signed proxies is doubtful (*Ernest* v. *Loma Gold Mines,* (1897) 1 *Ch.* 1). The secretary should carefully inspect all proxies before he accepts and acts on them on their votes all irregular proxies being reported to the directors. The proxies have to be lodged according to the regulations of the articles of association about two to four days prior to the holding of the meeting. When proxies are signed by an authorised agent of the shareholder or member, the power of attorney so authorising him to do this must also be lodged with the proxy. When the chairman declares that the poll should continue for a number of days the meeting is in law continuing during these days (*Reg.* v. *Wimbledon Local Board,* (1882) 8 *Q. B. D.* 459). In the case of foreign shareholders the proxies may be lodged at the company's office abroad and the result telegraphed to the head office (*English Scottish and Australian Bank,* (1893) 3 *Ch.* 385). Of course a proxy may be revoked at any time before the person appointed thereby has acted upon it, and a message sent to the chairman, or the secretary, either orally, or in writing is sufficient for that purpose. In the case of a corporation or a joint stock company holding shares in another joint stock company it can appoint any of its members as a proxy. Where the proxies have been lodged and shareholders attending the meeting wish to exercise their votes, the proxies are considered as cancelled (*Cousins* v. *International Brick Co.,* (1931) 2 *Ch.* 90).

FORM OF ARTICLES OF INDIAN COMPANIES IN CONNECTION WITH POLLS

By whom Poll may be Demanded

A poll shall be taken if, before or immediately upon the declaration by the chairman of the meeting of the result of the show of hands, it be demanded by the chairman or by or on behalf of at least three members present and entitled to vote at the meeting. If a poll is demanded as aforesaid, it should be taken in such manner and as such time and place as the chairman of the meeting directs and either at once or after an interval or adjournment or otherwise, and the result of the poll should

be deemed to be the resolution of the meeting at which the poll was demanded.

At General Meeting unless Poll Demanded, Chairman's Decision to be final

At any general meeting unless a poll be demanded a declaration by the chairman that resolution has been carried or has been carried unanimously or has been carried by a particular majority and an entry to that effect in the book of proceedings of the company shall be conclusive evidence of the fact without proof of the number or proportion of the votes for or against such resolution.

In what Case Poll taken without Adjournment

Any poll duly demanded on the election of a chairman of a meeting or on any question of adjournment shall be taken at the meeting and without adjournment.

Demand for Poll not to Prevent Transaction of other Business

The demand for a poll shall not prevent the continuance of a meeting for the transaction of any business other than the question on which the poll has been demanded.

An alternative set of articles to the same effect runs as follows :—

Form of Demand for Poll

A demand for a poll shall be made in the following or similar forms :—

We, the undersigned members of the prospective manufacturing Co., Ltd., hereby demand that the votes of this day's meeting on the undermentioned proposition submitted to it may be taken by poll.

Dated this......................day of................19....

Poll, how to be taken

If a poll is duly demanded as aforesaid, the same, if on the election of chairman of a meeting, or on any question of adjournment, shall be taken at the meeting and without adjournment, if on any other question, shall be taken in such manner, and at such time and place in Bombay, and either by open voting or by ballot,

as the chairman of the meeting shall direct, and either at once, or after an interval or adjournment, or otherwise, and the result of the poll shall be deemed to be the resolution of the meeting at which the poll was demanded, as of the date of taking the poll. Two scrutineers shall be appointed by the chairman from amongst those present at the meeting at which the poll is demanded, but in the event of no one accepting the post, the chairman alone shall be scrutineer. The demand for a poll may be withdrawn.

FORM OF ARTICLES OF INDIAN COMPANIES WITH REGARD TO VOTES AT MEETINGS AND PROXIES

Votes :—Upon a show of hands every member entitled to vote and be present in person or by a person duly authorised under a power-of-attorney shall save one vote, and upon a poll, every member entitled to vote and present in person or by a person duly authorised under a power-of-attorney or by proxy shall have one vote for every share held by him.

No Voting by Proxy on Show of Hands

No member not personally present shall be entitled to vote on a show of hands unless such member is present by a person duly authorised under a power-of-attorney or unless such member is a corporation present by proxy or a company present by a representative duly authorised under Sec. 80 of the Act in which case such person, proxy or representative may vote on a show of hands as if he were a member of the company.

No Member to Vote unless Calls are Paid up

No member shall be entitled to be present or to vote at any general meeting either personally or by proxy or attorney or as a proxy or attorney for any other member or be reckoned in a quorum whilst any call or other sum shall be due and payable to the company in respect of any of the shares of such member.

Votes in Respect of Shares of Deceased, or Insolvent Members

Any person entitled under the transmission (clause No..... hereof) to transfer any shares may vote at any general meeting in respect thereof as if he was the registered holder of such shares provided that at least 48 hours before the time of holding the meeting or adjourned meeting as the case may be at which he proposes to vote he shall satisfy the directors of his right to transfer

such shares, unless the directors shall have previously admitted his right to vote at such meeting in respect thereof.

Votes may be given by Proxy or a Power-of-Attorney

Votes may be given either personally or by a person duly authorised under a power-of-attorney or by proxy or in the case of a company by a representative duly authorised as aforesaid.

Appointment and Qualification of Proxy

Every proxy shall be appointed in writing under the hands of the appointor, or by a person duly authorised under a power-of-attorney or if such appointor is a company or corporation under the common seal of such company or corporation or the hand of its attorney who may be the appointor. Every instrument or proxy shall be attested by at least one witness. No person shall be appointed a proxy who is not a member of the company and qualified to vote, save that a company or corporation being a member of the company may appoint as its proxy any person though not a member of the company.

Deposit of Instrument of Appointment

No person shall act as proxy unless the instrument of his appointment and the power-of-attorney, if any, under which it is signed, shall be deposited at the office of the company at least forty-eight hours before the time for holding the meeting or adjourned meeting, as the case may be, at which he proposes to vote; but no instrument appointing a proxy shall be valid after the expiration of twelve months from the date of its execution unless in the case of the adjournment of any meeting first held previously to the expiration of such time.

Custody of the Instrument

If any such instrument of appointment be confined to the object appointing an attorney or proxy or substitute for voting at meetings of the company it shall remain permanently or for such time as the directors may determine, in the custody of the company; if embracing other objects, a copy thereof, examined with the original, shall be delivered to the company to remain the custody of the company.

Form of Proxy

Every instrument of proxy whether for a specified meeting or otherwise shall, as nearly as circumstances will admit, be in the form or to the effect of the following :—

THE PROSPECTIVE MANUFACTURING CO., LTD.

I,..

of..................................a member of the Prospective Manufacturing Co., Ltd. do hereby appoint........................ ....of.............................. (or failing him..................................of............... ....as my proxy to attend and vote for me and on my behalf at the ordinary) or extraordinary, as the case ....day of...........and at any adjournment thereof (or may be) general meeting of the company to be held on the........ day of and at any adjournment thereof (or at any meeting of the company that may be held within the period of twelve months from the date hereof).

As witness my hand this.............day of...........193.. ....signed by the said............................in the presence of..........................

Validity of Votes given by Proxy Notwithstanding Death of Member, etc.

A vote in accordance with the terms of an instrument of proxy shall be valid notwithstanding the previous death of the principal, or revocation of the proxy or of any power-of-attorney under which such proxy was signed, or the transfer of the share in respect of which the vote is given, provided that no intimation in writing of the death, revocation or transfer shall have been received at the office before the meeting.

Time for Objections to Votes

No objection shall be made to the validity of any vote except at the meeting or poll at which such vote shall be tendered and every vote, whether given personally or by proxy, not disallowed at such meeting or poll, shall be deemed valid for all purposes of such meeting or poll whatsoever.

Chairman of any Meeting to be the Judge of Validity of any Vote

The chairman of any meeting shall be the sole judge of the validity of every vote tendered at such meeting. The chairman present at the taking of a poll shall be the sole judge of the validity of every vote tendered.

DILATORY MOTIONS

These are resolutions moved with a view to prevent or delay the discussion and are in order if moved in

furtherance of the object for which the meeting has been called. They may be for any of the following objects :—

(1) With a view to adjourn the meeting. The form of the resolution will be "that this meeting be now adjourned";

(2) With a view to drop an item on the agenda from discussion, *e.g.*, "that this meeting do proceed to the next business";

(3) With a view to adjourn the debate. Here the mover of the resolution is allowed to speak on this adjournment but no one else is permitted to speak on it;

(4) With a view to prevent further discussion on a proposition which is considered by a large number of members at the meeting undesirable or unwise to discuss in the general interest of the body at the meeting, or from the discussion of which no good is likely to result to any one. In other words it is a device to shelve the motion. This resolution is technically known as the "previous question." The form in which it is moved is that "This question be not now put." As soon as seconded, the chairman usually puts these resolutions to the meeting and it takes precedence of all other motions. No amendment is allowed on a "previous question" nor can it be discussed, nor superseded by a motion for adjournment. The "previous question" should be put, either when the original proposition is before the meeting for discussion, or after the amendment is passed and the amended motion is put before the meeting as a substantive motion. It cannot be put during the course of the discussion of the amendment itself. The mover of this question has no right of reply.

THE MODE OF ADDRESS

All members addressing the meeting should make it a rule to address the chairman, not members, and must remain standing while doing so. He should not call the chairman by name, but refer to him by his official designation, *viz.* "Mr. Chairman." The member addressing the

chair should speak out his remarks extempore as reading from manuscripts may be objected to by the meeting. The language must be courteous and on no account should it be offensive or personal. Unnecessary repetition must be avoided. Except in committee meetings no one has a right of a second speech, except the mover of the proposition. If any one present finds that anything irregular is being done, or any objectionable language or remark is being made, he may rise to interrupt the speaker with the remark " Mr. Chairman, I am very sorry to interrupt, but I must rise to a point of order that.........." and may state his grounds. The chairman's ruling on a point of order must be taken as final. Even if the speaker thinks that the ruling of the chair was wrong, he must acquiesce for the time being, reserving his right to take in the future such action at law as may be thought necessary. This question was decided in *Henderson* v. *Bank of Australasia,* (1890) 45 *Ch. D.* 330 where the member concerned rose to a point of order and on the ruling of the chairman against him acquiesced and did not even protest. He thereafter took part in the debate on the resolution concerned and voted on it. When thereafter he applied to the Court with a view to get the chairman's ruling declared to be wrong, it was urged against him that he having acquiesced without even protest, and taken part in proceedings, was precluded from bringing this action. *Fry, L. J.* supported the attitude taken up by the member. In his judgment he laid down that by mere acquiescence not only did the member not lose his rights, but he acted as a decent man should do. According to *Lopes, L. J.*, he was not bound to challenge the ruling of the chair for the simple reason that it would be improper and indecent to do so.

If the speaker is referring to something in a previous speaker's address, or to any other course of conduct about some one present, the party so referred to, may also rise and address the chair with the remark " Mr. Chairman, I am sorry to interrupt, but as a matter of personal explanation I must state............ ". This personal explanation

should be a brief explanation and should not under any circumstances be a second speech.

As soon as the chairman calls out "order, order," the meeting must obey. The person to whom the words are addressed must immediately take the hint and the rest should support the chair. If the chairman proves to be an unreasonable autocrat, the remedy is not to create a disturbance and break up the meeting, but to take such constitutional steps as will ensure his removal. As far as the meeting is concerned, every member should readily submit to the disciplinary control of the chair, as he is there to co-operate with the chair both to preserve order and to facilitate the despatch of business as laid down in the agenda.

ADJOURNMENTS

Generally speaking, in common law it is the inherent right of the meeting of any corporate body to decide by a majority that it should adjourn and such motions may be brought in at any time during the course of proceedings when they would take precedence over all other matters as soon as they are proposed. At common law it is not even necessary that these motions should be seconded, or that they should be presented to the chairman in writing (*R.* v. *Wimbledon Local Board,* (1882) 8 *Q. B. D.* 459; *R.* v. *Gaborian,* (1809) 11 *East* 77). In a joint stock company, however, Sec. 77 (9) of the Indian Companies Act, 1913 lays down in case of a statutory meeting that "the meeting may adjourn from time to time, etc.," which signifies that at the statutory meeting the power to adjourn is entirely in the hands of the majority of the meeting as laid down by the statute and that the chairman has no voice in it. In general meetings however, the clauses in the articles of association govern the position.

The Form of Articles as to Adjournment

The usual article used in India is the adaptation of Article 55 of Table "A" which runs as follows :—

The chairman may, with the consent of any meeting at which a quorum is present (and shall if so directed by the meeting), adjourn the meeting from time to time and from place to place, but no business shall be transacted at any adjourned meeting other than the business left unfinished at the meeting from which the adjournment took place. When a meeting is adjourned for ten days or more, notice of the adjourned meeting shall be given as in the case of an original meeting. Save as aforesaid, it shall not be necessary to give notice of an adjournment or of the business to be transacted at an adjourned meeting.

In some cases the Indian Companies use a simple form as follows :—

The chairman may, with the consent of the meeting, adjourn any meeting from time to time and from place to place in Bombay.

An alternative clause to the above runs as follows :—

The chairman may, with the consent of a majority of the members personally present at any meeting, adjourn such meeting from time to time and from place to place in Bombay, but no business shall be transacted at any adjourned meeting other than the business left unfinished at the meeting from which the adjournment took place.

In connection with the last two forms it should be noted that the chairman may adjourn when requested by a majority, which means that it is entirely at his discretion to adjourn, or not, even though the majority may resolve that he should do so (*Salisbury Gold Mining Co.* v. *Hathorn*, (1897) *A. C.* 268), although in the first form adapted from 'Table A' he is bound to adjourn the meeting if the majority to do so. In no circumstances, unless specific powers are given to him in the articles, can the chairman adjourn the meeting at his will and pleasure without the consent of the meeting so as to prevent the meeting from transacting the business for which it was convened, and if the chairman were to do so the meeting can proceed by electing a new chairman (*National Dwellings Society* v. *Sykes*, (1894) 3 *Ch.* 159; *Catesby* v. *Burnett*, (1916) 2 *Ch.* 325). The only exception where it is said that the chairman may adjourn on his own initiative is where the

circumstances have arisen which make it impossible to conduct the business properly (*R.* v. *D'Oyly,* (1840) 12 *A. & E.* 139). When a meeting is adjourned, under the Indian law the adjourned meeting is legally the continuation of the original meeting and therefore, the date of the original meeting is the date of the meeting irrespective of the number of times for which the said meeting is adjourned (*R.* v. *Hedger,* (1840) 12 *A. & E.* 139). The English law on this point has now been altered by the English Companies Act, 1929 Sec. 119 by which it is laid down that in case of a resolution passed after the commencement of the Act at an adjourned meeting the same will for all purposes be deemed to have been passed on the date on which the said resolution was in fact passed and shall not be deemed to have been passed on any earlier date.

The adjourned meeting will be a continuation of the same meeting and a fresh notice will not be necessary, unless the articles of association require same (*Scadding* v. *Lorant,* (1851) 3 *H. L. C.* 418; *Wills* v. *Murray,* (1850) 4 *Ex.* 843).

POSTPONEMENTS

We have already seen that when a meeting has been called and notice given, the directors have no power in the absence of a specific article to that effect, to postpone the meeting (*Smith* v. *Paringa Mines,* (1906) 2 *Ch.* 193). The only manner in which the matter can be arranged is by holding the meeting as notified and thereat fixing another date through an adjournment motion.

DEFAMATORY STATEMENTS AT MEETINGS

Board Meetings

As far as board meetings are concerned it has been held that the directors of a company had a duty to discuss the affairs of the company and might discuss the conduct of the company's affairs so long as they did so honestly. In short, the occasion is, as the law calls it, a privileged

one. There should, however, be no evidence of malice or spite in connection with the making of any statement which must be made as a matter of duty disclosed for the benefit of the company which the brother directors must know in order to be able to arrive at a correct decision on the question under discussion. Thus the party who brings a charge of defamation against a director must prove that the words spoken were spoken maliciously (*Royal Aquarium* v. *Parkinson,* (1892) 1 *Q. B.* 443).

Not only is the director responsible but technically speaking if the minutes are printed and circulated the printer is also responsible for publication of the libel if he published the minutes containing the defamatory statement made at the directors' meeting. In such cases of publication by printers there is no question of malice but the printer is liable for defamation.

Meetings of Shareholders

No doubt there is the qualified privilege of fair comment in meetings of shareholders. This fair comment is available only with regard to statements on matters of public interest and statements made at a company meeting which are vital to the interests of the shareholders. Of course, there should be no malice and it should be remembered that " malice " is not confined to personal spite and ill-will, but also includes every unjustifiable intention to inflict injury on the person defamed or every wrong feeling in a man's mind (*Stuart* v. *Bell,* (1891) 2 *Q. B.* 341). A privilege communication is one which is made *bona fide* in pursuance of a duty or with a fair and reasonable purpose of protecting the interests of the party using the words (*Watt* v. *Langsdon,* (1929) 45 *T. L. R.* 619). In a shareholders' meeting the speaker who generally is a shareholder has to speak on a matter in which he is himself interested as a shareholder and in which his brother shareholders are also interested and thus if he speaks without malice it will be a privileged occasion and he will be protected.

Definition of Defamation

With reference to defamation the Indian Penal Code, 1860, lays down in Sec. 499 the following rules and exceptions which made clear the law on the subject. The Code makes defamation punishable with simple imprisonment for a term which may extend to two years, or with a fine, or with both. Apart from the criminal side of it the party injured by the defamation has a right to bring a suit in a Civil Court for damages sustained by him through his being defamed.

Defamation.

Sec. 499. Whoever by words either spoken or intended to be read, or by signs or by visible representation, makes or publishes any imputation concerning any person intending to harm, or knowing or having reason to believe that such imputation will harm, the reputation of such imputation will harm, the reputation hereinafter excepted, to defame that person.

Explanation 1—It may amount to defamation to impute anything to a deceased person, if the imputation would harm the reputation of that person if living, and is intended to be hurtful to the feelings of his family or other near relatives.

Explanation 2.—It may amount to defamation to make an imputation concerning a company or an association or collection of persons as such.

Explanation 3.—An imputation in the form of an alternative or expressed ironically, may amount to defamation.

Explanation 4.—No imputation is said to harm a person's reputation, unless that imputation directly or indirectly, in the estimation of others, lowers the moral or intellectual character of that person, or lowers the character of that person in respect of his caste or of his calling, or lowers the credit of that person, loathsome state, or in a state generally considered as disgraceful.

Illustrations

(*a*) A says—"Z is an honest man; he never stole B's watch"; intending to cause it to be believed that Z did steal B's watch. This is defamation, unless it fall within one of the exceptions.

(*b*) A is asked who stole B's watch. A point to Z, intending to cause it to be believed that Z stole B's watch. This is defamation, unless it fall within one of the exceptions.

(*c*) A draws a picture of Z running away with B's watch, intending it to be believed that Z stole B's watch. This is defamation, unless it fall within one of the exceptions.

Imputation of truth which public good requires to be made or published.

FIRST EXCEPTION.—It is not defamation to impute anything which is true concerning any person, if it be for the public good that the imputation should be made or published. Whether or not it is for the public good is a question of fact.

Public conduct of public servants.

SECOND EXCEPTION.—It is not defamation to express in good faith any opinion whatever respecting the conduct of public servant in the discharge of his public functions, or respecting his character, so far as his character appears in that conduct, and no further.

Conduct of any person touching any public question.

THIRD EXCEPTION.—It is not defamation to express in good faith any opinion whatever respecting the conduct of any person touching any public question, and respecting his character so far as his character appears in that conduct, and no further.

Illustrations

It is not defamation for A, to express in good faith any opinion whatever respecting Z's conduct in petitioning Government on a public question, in signing a requisition for a meeting on a public question, in presiding or attending at such meeting, in forming or joining any society which invites the public support, in voting or canvassing for a particular candidate for any situation in the efficient discharge of the duties of which the public is interested.

Publication of reports of proceedings of Courts.

FOURTH EXCEPTION.—It is not defamation to publish a substantially true report of the proceeding of a Court of Justice, or of the result of any such proceedings.

Explanation.—A Justice of the Peace or other officer holding an enquiry in open Court

preliminary to a trial in a Court of Justice is a Court within the meaning of the above section.

Merits of case decided in Court or conduct of witnesses and others concerned.

FIFTH EXCEPTION.—It is not defamation to express in good faith any opinion whatever respecting the merits of any case, civil or criminal, which has been decided by a Court of Justice, or respecting the conduct of any person as a party, witness or agent, in any such case, or respecting the character of such person, as far as his character appears in that conduct, and no further.

Illustrations

(*a*) A says—"I think Z's evidence on that trial is so contradictory that he must be stupid or dishonest." A is within this exception if he says this in good faith, inasmuch as the opinion which he expresses respects Z's character as it appears in Z's conduct as a witness, and no further.

(*b*) But if A says—"I do not believe what Z asserted at that trial, because I know him to be a man without veracity." A is not within this exception, inasmuch as the opinion which he expresses of Z's character, is an opinion not founded on Z's conduct as a witness.

Merits of public performance

SIXTH EXCEPTION.—It is not defamation to express in good faith any opinion respecting the merits of any performance which its author has submitted to the judgment of the public, or respecting the character of the author so far as his character appears in such performance, and no further.

Explanation.—A performance may be submitted to the judgment of the public expressly or by acts on the part of the author which imply such submission to the judgment of the public.

Illustrations

(*a*) A person who publishes a book, submits that book to the judgment of the public.

(*b*) A person who makes a speech in public, submits that speech to the judgment of the public.

(*c*) An actor or singer who appears on a public stage submits his acting or singing to the judgment of the public.

(*d*) A says of a book published by Z—"Z's book is foolish; Z must be a weak man. Z's book is indecent; Z must be a man of impure mind." A is within this exception, if he says this in good faith, inasmuch as the opinion which he expresses is an opinion founded upon Z's book, and no further.

(*e*) But if A says—"I am not surprised that Z's book is foolish and indecent, for he is a weak man and a libertine." A is not within this exception, inasmuch as the opinion which he expresses of Z's character is an opinion not founded on Z's book.

Censure passed in good faith by person having lawful authority over another.

SEVENTH EXCEPTION.—It is not defamation in a person having any authority, over another either conferred by law or arising out of a lawful contract made with that other, to pass in good faith any censure on the conduct of that other in matters to which such lawful authority relates.

Illustrations

A Judge censuring in good faith the conduct of a witness, or of an officer of the Court; a head of a department censuring in good faith those who are under his orders; a parent censuring in good faith a child in the presence of other children; a schoolmaster, whose authority is derived from a parent censuring in good faith a pupil in the presence of other pupils; a master censuring a servant in good faith for remissness in service; a banker censuring in good faith the cashier of his bank for the conduct of such cashier as such cashier are within this exception.

Accusation preferred in good faith to authorized person.

EIGHTH EXCEPTION.—It is not defamation to prefer in good faith an accusation against any person to any of those who have lawful authority over that person with respect to the subject-matter of accusation.

Illustrations

If A in good faith accuses Z before a Magistrate; if A in good faith complains of the conduct of Z, a servant, to Z's master; or if A in good faith complains of the conduct of Z, a child, to Z's father—A is within this exception.

Imputation made in good faith by person for protection of his or other's interests.

NINTH EXCEPTION.—It is not defamation to make an imputation on the character of another, provided that the imputation be made in good faith for the protection of the interest of the person making it, or of any other person, or for the public good.

Illustrations

(*a*) A, a shopkeeper, says to B, who manages his business—"Sell nothing to Z unless he pays you ready money, for I have no opinion of his honesty." A is within the exception, if he has made this imputation on Z in good faith for the protection of his own interest.

(*b*) A, a Magistrate, in making a report to his superior officer, casts an imputation on the character of Z. Here, if the imputation is made in good faith, and for the public good, A is within the exception.

Caution intended for good of person to whom conveyed or for public good.

TENTH EXCEPTION.—It is not defamation to convey a caution, in good faith, to one person against another, provided that such caution be intended for the good of the person to whom it is conveyed or of some person in whom that person is interested, or for the public good.

It will thus be seen that the ingredients of defamation are (1) making or publishing any imputation concerning any person, (2) such imputation should have been made either by words spoken or intended to be read or by signs or by visible representations (3) the said imputation should have been made with the intention of harming or where there was knowledge or reason to believe that it will harm the reputation of the person concerning whom it was made. The Indian law differs from English law fundamentally in this matter because in English law the essence of the crime is the tendency to bring about a breach of peace through a libel : under the Indian law however, there is no question of the chance of a breach of peace occurring, but the defamation has been made on offence by itself.

The General Law on the Subject

The mere belief of the party making a defamatory statement that it was his duty to do so will not save or protect him, but the circumstances must be such as to make it his duty to speak (*Whiteley* v. *Adams*, (1863) 15 *C. B.* 392). On one occasion at an election meeting of an overseer a statement was made to the effect that the candidate had misappropriated parish moneys while hold-

ing the office before, it was considered privileged, but it was pointed out to the jury by the judge that the privilege would be lost if the making of it was a malicious abuse of the occasion (*George* v. *Goddard,* (1861) 2 *F. & F.* 689).

Presence of the Press and Press Reports

Generally speaking when the press happens to be present uninvited at a meeting of a corporation or board of guardians or where it is usual for their reporters to be present at a meeting it was held that the privilege is not taken away by the presence of reporters or persons other than the guardians (*In Pittard* v. *Oliver,* (1891) 1 *Q. B.* 474). In another case where the press was expressly invited to a shareholders' meeting and defamatory statements were made, it was held that though they were of great interest and importance to shareholders, the defamatory statements would have been excused if the shareholders alone had been present but as outsiders were expressly invited it was no longer a privileged occasion (*In Parsons* v. *Surgey,* (1864) 4 *F. & F.* 247). It will thus be seen that in this case the speaker lost his privilege because the press attended at special invitation, in this case an invitation by the speaker himself.

In one other case the question of the privilege of the press was considered. Here at a shareholders' meeting the chairman made certain defamatory statements against the cashier of the bank imputing dishonesty. The statements were false and the cashier received damages in a defamation case filed against the chairman. The *Financial Times,* however published the whole report of these proceedings of the shareholders' meeting. It was not denied that the report was fair and accurate, but it was held that there was no privilege here since the matter was not of any public concern and the publication was therefore not of public benefit or interest. As to the right of a reporter to attend company meetings it has been decided that a reporter in his capacity as a reporter has no right to attend such meetings but if he happens to be a shareholder he can

attend and make a report (*Mayor of Tenby* v. *Mason*, (1908) 1 *Ch*. 457).

The usual practice of companies is to print the report of a meeting and send it to its members. In this connection it has been held that the report is *prima facie* privileged and therefore in the absence of malice no action can be taken (*Lawless* v. *Anglo-Egyptian Cotton Co.*, (1869) *L. R.* 4 *Q. B.* 262). In a similar case where an order for injunction was discharged, a solicitor on behalf of some shareholders in a company printed and circulated a certain circular among the shareholders containing matters reflecting on certain officers of the company and the mode of the company's promotion. Here the circular was declared to be a privileged communication (*Quartz Hill Gold Mining Co.* v. *Beall*, (1882) 20 *Ch. D.* 508). When these circulars are issued the communication naturally becomes known in the ordinary course of business to clerks of the company or the party sending it out and in such cases also it has been decided that the privileged occasion covers such a publication of these statements (*Edmonson* v. *Birch & Co.*, (1907) 1 *K. B.* 371).

There are, of course, occasions when malice may be inferred, such as where unauthorised publications are issued which happen to be to the detriment of somebody (*Brown* v. *Croome*, (1817) 2 *Stark*. 301). Where the circular is issued in an exceptionally violent language, unjustifiable by the circumstances, such an inference of malice may arise (*Spill* v. *Maule*, (1869) *L. R.* 4 *Ex.* 232). However if the language used is *bona fide* though intemperate it may not be inferred as an evidence of malice (*Edmondson* v. *Birch & Co.*, (1907) 1 *K. B.* 371). Of course where the party is fully aware of the fact that the statements are untrue, or utters words with the deliberate intention of injuring the other side, or is actuated by personal resentment or wrong or improper motive, malice would be inferred (*Gerard & Dickenson*, (1590) 4 *Rep*. 18; *Hooper* v. *Truscott*, (1836) 2 *Bing. N. C.* 457; *Rogers* v. *Clifton*, (1803) 3 *B. & P.* 587).

CHAPTER XIV

Debentures and Borrowing

Borrowing Powers

The borrowing powers of a joint stock company depend upon its constitution and the nature of its business. Trading companies have implied powers to borrow for the purpose of their business. It is, however, customary for every company to reserve to itself the power to borrow in its memorandum, because otherwise, the company cannot borrow unless the nature of its business implies a borrowing power. Thus a school-board and a building society have been held not to have an implied power to borrow. Once the power to borrow is given, the company can charge or mortgage its property for the purpose of raising a loan, though generally, when the power of borrowing is taken, the power to mortgage is also expressly reserved. It has been decided that power to mortgage " assets " or " property and rights " or " property and effects " will include power to charge uncalled capital, but only " property " or " real and personal estate " or " property and funds " will not include such a power to borrow on uncalled capital unless articles specially declare the uncalled capital as chargeable property (*Hume* v. *Drachenfels, Banket Gold Mining Syndicate,* (1895) 2 *Mans.* 146). These powers to borrow are generally exercised by the board of directors, but the constitution of the company may lay down such rules as they may desire necessary with a view to curtail, or to provide a check on the directors' power to borrow. *Apart from the power to borrow the Indian Companies (Amendment) Act, 1936 lays down certain limitations on the powers of companies to lend money. Thus a company incorporated after the commencement of this act cannot make any loan to or guarantee any loan made by any*

company under the management of the same managing agent. Further after the expiry of six months from the commencement of the act no company whether incorporated before or after the act make any loan or give any guarantee except by way of renewal of any existing loan or guarantee. [S. 87E (1)]. Any default would entail, on any director or officer of the company knowingly and wilfully guilty a fine not exceeding one thousand rupees and they would be jointly and severally liable for any loss incurred by the company in respect of such loan or guarantee [S. 87E (2)]. The purchase of the shares or debentures of another company under the same management (except in case of an investment company) is also prohibited unless where the purchase has been previously approved by a unanimous decision of the board of directors of the purchasnig company (S. 87F). It is further laid down that a managing agent shall not exercise a power to issue debenture in case of a company under his management except with the authority of the directors, and that too within the limits fixed by them or a power to invest the funds of the company, and any delegation of such power by a company to a managing agent shall be void (S. 87G). Once the power to borrow is given and exercised by the proper authorities, it is not the lookout of outsiders to see that the various formalities required have been complied with by the officers of the company. For this purpose it has been held that overdrawing a banking account was in substance a borrowing of money (*In re. Pyle Works, No.* 2, (1891) 1 *Ch. D.* 184).

The lender has to take care to see not only that the company has the power to borrow, but that the said power is vested in the directors, because otherwise, his only remedy will be against the directors for damages in case the company repudiates the transaction (*Firbank's Executors* v. *Humphreys,* (1887) 18 *Q. B. D.* 54). If the directors borrow beyond the limits no debt is created and the securities are void (*Howard* v. *Patent Ivory Manufacturing Co.,* (1888) 38 *Ch. D.* 156). The fact that originally

ultra vires loans are attempted to be substantiated by a subsequent power to lend and subsequent issue of securities will not make them valid (*In re. Ex parte Watson,* (1888) 21 *Q. B.* 301; *Re. the Bottomgate Industrial Co-operative Society,* (1891) 65 *L. T.* 712; *Sinclair* v. *Brougham,* (1914) *Ap. Cas.* 398). It is also a principle that though the lender is not bound to inquire the purpose for which the money is borrowed, if he knows at the time he lends that the same is borrowed for an illegitimate purpose he cannot recover the money lent (*Davis's Case,* (1871) 12 *Eq.* 561). In case the loan is taken for a purpose which is not legitimate, the lender will not lose his money on that ground (if he did not know of this fact), because it has been held, that he is not bound to enquire as to the purpose for which the said loan was taken. All that he has to be satisfied about is that the company has general or specific powers to borrow money for the purpose of its business (*Young* v. *David Payne & Co. Ltd.,* (1904) 2 *Ch. D.* 608). In connection with this borrowing power it may be further added that where the memorandum, or the articles permit, a company can borrow money on the security of its uncalled capital just as well as it can on that of any of its assets (*Newton* v. *Debenture-holders and Liquidators of Anglo-Australian Investment Co.,* (1895) *A. C.* 244).

The borrowing by debentures is a very old method by which the Crown in old days in England used to acknowledge its indebtedness by giving certificates to its creditors or to soldiers and servants in connection with the payment of their wages. It is derived from the old latin word debenture. However, debenture as we know it in connection with company practice is a certificate issued by the company acknowledging the debt due by it to its holders. It may be carrying a charge, or it may be without a charge on the property of the company. *Chitty, J.,* while speaking of debentures states as follows :—

"The term itself imports a debt—acknowledgment of a debt and speaking of the numerous and various forms

of investments which have been called debentures without any one being able to say the term is incorrectly used, I find that generally, if not always, the instrument imports an obligation or covenant to pay. This obligation or covenant is in most cases at the present day accompanied by some charge or security. So that there are debentures which are secured, and debentures which are not secured" (*Edmunds* v. *Blaina Furnaces Co.,* (1887) 36 *Ch. D.* 215). There may be a single debenture issued to one person (*Robson* v. *Smith,* (1895) 2 *Ch.* 118).

The usual practice in connection with companies is to issue these certificates called 'Debentures' under its seal or otherwise acknowledging that a certain sum has been borrowed by the company and provide for its repayment on the expiry of a certain date. In case however of what are known as irredeemable or perpetual debentures there is no undertaking of repayment of the capital amount borrowed at any date. In either case the debenture states the rate of interest and the time of periods of payment of same either yearly, half-yearly or otherwise. Frequently these debentures carry a charge on the company's assets as we shall see later in detail. Whereas there are also what are known as clean or naked debentures which do not carry such charge. Usually a series of debentures are issued, each known by its number, but there might be a single debenture for the whole amount borrowed issued to one person, as is the case when debentures are issued to bankers and others (*Levy* v. *Abercorris Slate and Slab Co.,* (1887) 37 *Ch. D.* 260; *Robson* v. *Smith,* (1895) 2 *Ch.* 118).

It is of course not necessary that a debenture should be under seal, because it may be signed by any director or officer of the company duly authorised to do so (*British India Steam Navigation Co.* v. *Commissioners of I. Revenue,* (1881) 7 *Q. B. D.* 165).

THE ISSUE OF DEBENTURES TO BORROW

In connection with this issue of debentures to borrow, the point to be remembered is that the paramount

consideration as to company's right to borrow, which right may be either implied by the nature of its business as is the case with trading companies, must be expressly given in the memorandum of association in case of what are called non-trading companies. In this connection the term non-trading companies is rather misleading as will be judged from the decisions which have been given. Thus a building society, a school-board, a literary and scientific institution were held not to be entitled to borrow in absence of specific powers to do so (*Blackburn Benefit Building Society* v. *Cunliffe Brooks*, (1882) 22 *Ch. D.* 61; *Regina* v. *Sir Charles Reed*, (1880) 5 *Q. B. D.* 483; *In re. Badger*, (1905) 1 *Ch.* 568). On the other hand a colliery company, an omnibus company, a shipping company have been held to have an implied power to borrow (*Jackson* v. *Rainford Coal Co.*, (1896) 2 *Ch.* 340; *Bryan* v. *Metropolitan Saloon Omnibus Co.*, (1858) 3 *De. G. & J.* 123; *Australian A. Steam Clipper Co.* v. *Mounsey*, (1858) 27 *L. J. Ch.* 729).

A trading or a commercial company has an implied power to borrow (*General Auction Estate Co.* v. *Smith*, (1891) 3 *Ch.* 432; *Bank of Australasia* v. *Breillat*, (1847) 6 *Moo. P. C.* 195) where debentures were issued to buy over management right with annual charge of 50 per cent. on net profits, the agreement was held not to be *ultra vires* (*Investment Trust Corporation Ltd.* v. *Singapore T. Co. Ltd.*, (1935) 1 *Ch. D.* 615).

The modern practice followed by draftsmen of the memorandum of association is to specifically give powers to borrow in case of all companies whether trading or non-trading and these specific powers are not only expressed in general terms, but also in so many specific types of borrowing also. This practice is no doubt in the interest of laymen who have to deal with such a memorandum as the details make clear the extent of the borrowing powers of the company concerned.

The difference between a debenture bond and a debenture stock is the same as between a stock and a share, otherwise there is no substantial difference between the

position of holders of either of these documents. In case of debenture stock the actual position is that instead of each debenture securing a definite amount separately, as is the case with ordinary debentures, the whole sum secured is treated as one stock and each certificate issued simply declares the holder to be entitled to a definite sum which is the part of that single stock. This division is generally made according to the terms of issue for any multiple of a rupee or a pound or may even include a fraction of that denomination. Thus it is said that a debenture stock is transferable in fractions, whereas a debenture bond, like a share, as distinguished from a stock, can only be transferred in full. The debenture stock may also carry a charge or mortgage and may also be irredeemable if the terms of issue so provide. In all other respects otherwise they are on the same footing. Not only should a lender on debentures take care to see that the company has the power to borrow, but that the directors who manage the company have also the same power which will be found out from the articles of association. This is necessary because frequently the directors' powers to borrow and mortgage are expressly limited by articles and any borrowing beyond these limits would be void and would not create any debt, legal or equitable, with the result that the security on which the loan is made would be void (*Howard* v. *Patent Ivory Manufacturing Co.*, (1888) 38 *Ch. D.* 156; *Wenlock* v. *River Dee Co.*, (1885) 10 *A. C.* 354; *Birkbeck Permanent Benefit Building Society*, (1912) 2 *Ch.* 183). It would not improve matters if an *ultra vires* loan is borrowed and then the company obtains a power to borrow and issues securities in connection with that previously obtained loan (*Ex parte Watson*, (1882) 21 *Q. B. B.* 301; *Bottomgate Industrial Society*, (1891) 65 *L. T.* 712). The position of these lenders of unauthorised loans may be that they get subrogated in the place of those creditors whose loans were authorised and who were paid out from this *ultra vires* borrowing.

On the question whether a company having no express power of effecting a charge or mortgage, can under its

implied power mortgage or charge its uncalled capital, there is some doubt as the decisions have mostly turned on construction. The *obiter dicta* in *Page* v. *The International Agency & Industrial Trust,* (1893) 68 *L. T.* 435 states that this cannot be done. In other cases the construction played an important part in connection with this power of charging the uncalled capital (*Stanley's Case,* (1864) 4 *De. G. J. & S.* 407, *Newton* v. *Anglo-Australian Investment Co.,* (1895) *A. C.* 244). There is no reason however according to the best authorities as to why an implied power to charge the uncalled capital should not be there in case the company is a trading company, or of that class, where power to borrow is implied. However in absence of a definite section in the Act or decision on that point, the question must remain doubtful. The power to issue debentures conferred by the memorandum of association is wide enough and the articles also in general terms may imply a verbal charge on uncalled capital (*Tilbury Portland Cement Co.,* (1893) 62 *L. J. Ch.* 814). When a company has power to issue debentures express or implied, these debentures can be issued to its principal shareholder or to a vendor in consideration of a sale (*Salomon* v. *Salomon & Co.,* (1897) *A. C.* 22). The power to borrow and give security includes the power to charge existing debts (*Bank of Australasia* v. *Breillat,* (1847) 6 *Moor P. C.* 195; *Inns of Court Hotel Co., Re.,* (1868) *L. R.* 6 *Eq.* 82; *Davies* v. *R. Bolton & Co.,* (1894) 3 *Ch.* 678).

Of course the simple rule of *ultra vires* borrowing would apply here. If the memorandum of association does not justify a particular borrowing the loan would of course be void (*Chapleo* v. *Brunswick Permanent Building Society,* (1881) 6 *Q. B. D.* 696; *Wenlock* v. *River Dee Co.,* (1885) 10 *A. C.* 354). If on the other hand the said borrowing, though, within the powers of the company was beyond the powers of directors, the company can ratify same either by acquiscence or by alteration of articles or by passing a resolution confirming the borrowing (*Irvine* v. *Union Bank of Australia,* (1877) 2 *A. C.* 366). The ordinary rule of

law prevails that the lender is not bound to enquire the purpose for which the money is being borrowed (*Marseilles Extension Ry. Co.*, (1872) 7 *Ch.* 161; *Young* v. *David Payne & Co.*, (1904) 2 *Ch.* 608). However, if the lender happens to be a director he will be expected to know and enquire whether the proper steps were taken in connection with the loan by the officers of the company (*Howard* v. *Patent Ivory Co.*, (1888) 38 *Ch. D.* 156).

The power to mortgage property includes future property and goodwill (*Anglo-American Cloth Co.*, (1880) 43 *L. T.* 43). But where a charge is given on "all assets" that would include money recoverable from directors for misfeasance, which must be paid in preference to the cost of liquidation, but not the liquidator's cost incurred in connection with recovering the particular assets charged (*Park Gate Waggon Co.*, (1881) 17 *Ch. D.* 239; *Anglo-Australian Printing Co.*, (1895) 2 *Ch.* 891; *Barned's Banking Co.*, (1871) 6 *Ch.* 388). It has been also held that a sole holder of a company's debentures may purchase the company's property sold by the trustee for debenture holder in exercise of the power contained in the debenture trust deed (*Kanhaya Lal* v. *The National Bank of India*, (1923) 50 *Ind. Ap.* 162).

With regard to uncalled capital, where there is no specific power to mortgage same, that cannot be done if the same is afterwards made a reserve capital for the purpose of winding up by a special resolution under Sec. 69 (*Bartlett* v. *Mayfair Property Co.*, (1898) 2 *Ch.* 28). The power to borrow does not imply a joint borrowing by the company with outsiders, but when this is done any charge given by it will be good only to the extent of the actual loan received by the company itself (*Johnston Foreign Patents Co.*, (1904) 2 *Ch.* 234). It has also been held that a company is not precluded in guaranteeing the interest on debenture of another company where it is so done to promote the interests of its own business (*Ex parte Brooker*, (1880) 14 *Ch. D.* 317). A lender of money to a company is naturally under the general rules of

company law expected to have acquainted himself with the contents of the memorandum and articles of association which are public documents (*Bargate* v. *Shortridge,* (1855) 5 *H. L. C.* 297; *Ernest* v. *Nicholls,* (1857) 6 *H. L. C.* 401). This is most important where, as is frequently the case, the memorandum or articles lay down a limit beyond which the directors cannot borrow (*Chapleo* v. *Brunswick Building Society,* (1881) 6 *Q. B. D.* 696; *Fountaine* v. *Carmarthen Ry. Co.,* (1868) *L. R.* 5 *Eq.* 316; *Irvine* v. *Union Bank of Australia,* (1877) 2 *A. C.* 366). Frequently the powers to borrow may not be given to the directors and may be given only to the company, in which case the lender should see that the consent of the company in general meeting is obtained (*Cartmell's Case,* (1874) 9 *Ch.* 961; *Howard's Case,* (1866) 1 *Ch.* 561). When certain powers are to be exercised by directors and the person giving the loan thinks that he is dealing with the directors who are *de facto* directors, but unknown to him are not *de jure* directors, he would be protected (*Mohony* v. *East Holyford Mining Co.,* (1875) *L. R.* 7 *H. L.* 869). In connection with *de facto* directors it has been held in a number of cases to the effect that acts of *de facto* directors are binding until the persons have notice of their being *de facto* directors (*Murray* v. *Bush,* (1873) *L. R.* 6 *H. L.* 37; *Bridport Old Brewery,* (1867) 2 *Ch.* 191). When negotiations are being carried on for borrowing money from banks on debentures, the latter usually requires the personal guarantee of directors or managing agents in addition to the debenture. In these cases the position of the directors and the managing agents would be that of sureties with their usual rights and liabilities as sureties, including that of contribution among themselves (*Ex parte Gibbs,* (1875) 10 *Eq.* 312). If a company which has virtually speaking exhausted its borrowing powers borrows further with a view to repay the old creditors, the new creditors so lending will be entitled to the repayment of that part of money which has been applied in paying the lawful debts of

the company whether such debts existed at the time when the loan were made or subsequently to it (*Cork & Youghal Ry. Co.*, (1869) 2 *Ch.* 748; *Baroness Wenlock* v. *River Dee,* (1887) 19 *Q. B. D.* 155; *Blackburn Benefit B. Society* v. *Cunliffe Brooks,* (1882) 22 *Ch. D.* 61). In this case the test is whether the company has substantially increased its debts by the unauthorised borrowing (*Bannatyne* v. *D. & C. MacIver,* (1906) 1 *K. B.* 103). A lender who has advanced a loan in excess of the borrowing powers of the company, can recoup himself from such moneys belonging to the company which happen to have come into his possession, unless it can be shown that the money which was wrongfully borrowed from him has been lost (*Sinclair* v. *Brougham,* (1914) *A. C.* 398). However in this case, if he can identify the money lent in the hands of the company, he can recover same (*Banque Belge* v. *Hambrouck,* (1921) 1 *K. B.* 321, *see also Sinclair's Case given above*). Where a company has exhausted its borrowing powers on loan made to a third party at the request of the company, it does not give the right to the creditor of following the money even though they may have been applied in payment of debts, or in fact any right against the company (*Portsea Island Building Society* v. *Barclay,* (1895) 2 *Ch.* 298). Where a company was authorised to borrow to the extent of capital not called up it was held that this expression included unissued shares (*English Channel Steamship Co.* v. *Rolt,* (1881) 17 *Ch. D.* 715). Where there is a power to borrow a sum not exceeding the preference share capital of the company it does not mean that the company cannot borrow unless and until these preference shares have been actually issued (*Johnston Foreign Patents Co.,* (1904) 2 *Ch.* 234). Debentures issued after the borrowing powers of the company have been exhausted are void and not merely voidable (*Pooley Hall Colliery,* (1869) 21 *L. T.* 690). In this case the directors who issued such debentures in spite of the fact that the borrowing power was exhausted are personally liable on the ground of breach of warranty of authority

and they would have to pay damages for the loss suffered by the persons to whom these debentures were issued (*Fairbanks' Case* v. *Humphreys*, (1887) 18 *Q. B. D.* 54).

CLASSES OF DEBENTURES

The debentures are divided into two main classes, *viz.*, (1) registered debentures and (2) bearer debentures. Either of these two classes may be debentures which are (a) unsecured or (b) secured. The unsecured debentures are now a days rare and they do not carry any charge on the assets of the company. This means that the holder of an unsecured debenture is an ordinary creditor of the company. In case of secured debentures there is a further sub-division, *viz.*, that :—

(1) the charge may be a floating charge on the whole of the undertaking of the company, or

(2) it may be a specific charge over stated assets usually immovable property or both, and

(3) it may be both floating and specific charge.

Registered Debentures

The bulk of the debentures issued by most of the companies in India are registered debentures. They are called registered because the name of the holder of such debentures is recorded in the books of the company as well as in the certificate issued. Thus in order to transfer them, a regular transfer form will have to be filled in and signed. This is the safest type of debentures, because in case of bearer debentures, as we shall soon see, they being negotiable instruments, a loss or misplacement of the debenture and the same passing into the hands of a *bona fide* holder for value would deprive the owner of his rights. The other advantage is that the names of the holders being registered in the books of the company, notices and other communication could be sent to them direct by the company instead of through the indirect method of communicating with them through newspapers. The interest due on these registered debentures may be

paid either by interest warrant drawn on company's bankers posted to the registered holder or to the first named of joint holders. There is the other method, as we have seen above, of attaching to the debenture bond or certificate the series of interest coupons which are to be cashed by the holder as each falls due, and when the last of the coupons is being cashed, which is known as the "talon," the company issues to the holder a fresh series of coupons for future interest payments.

Debentures to Bearer

This form of debentures is quite familiar to English investors though they are rather rare over here. *Kennedy, J.* in *Bechuanaland Exploration Co.* v. *London Trading Bank,* (1898) 2 *Q. B.* 658, decided in case of bearer debentures that according to the "usage of the mercantile world the debentures were treated as negotiable instruments, passing like promissory notes, or bank notes, by mere delivery from hand to hand" (*See also Venables* v. *Baring Bros. & Co.*, (1892) 3 *Ch.* 527). In a subsequent case *Edelstein* v. *Schuler & Co.*, (1902) 2 *K. B.* 144 it was laid down that it was not now necessary to tender evidence to prove that bonds of this kind are negotiable instruments that being a fact of which the Court will take judicial notice (*Rumball* v. *Metropolitan Bank,* (1877) 2 *Q. B.* 194; *Goodwin* v. *Roberts,* (1876) 1 *A. C.* 476).

The other decisions where debentures have been declared to be negotiable instruments are *Goodwin* v. *Roberts,* (1875) 10 *Ex. Cas.* 337 in which the foreign government scrips payable to bearer were declared negotiable instruments and *Bechuanaland Exploration Co.* v. *London Trading Bank,* (1898) 2 *Q. B.* 658 was a case of English bearer debentures. The holders of bearer debentures are in some cases given the right to get their debentures converted into registered debentures and *vice versa.* In case of bearer debentures where the holders cannot be found it may be necessary for the company or the trustee to apply to the Court for direction. In English Courts

summons for direction have to be taken out for this purpose. Interested parties and the attorney general are to be made parties (*Re. Chillago Ry. & Mines Ltd.,* (1930) 46 *T. L. R.* 242).

Redeemable or Irredeemable Debentures

In this connection the provision of Sec. 126 of the Indian Companies Act is important. The section lays down as follows :

Sec. 126 :—" A condition contained in any debenture or in any deed for securing any debentures, whether issued or executed before or after the passing of this Act, shall not be invalid by reason only that thereby the debentures are made irredeemable or redeemable only on the happening of a contingency, however remote, or on the expiration of a period, however long."

Here it should be noted that an irredeemable debenture is not in fact a mortgage at all but it is in effect an annuity in perpetuity to the holder. The word irredeemable may mean either that they are debentures which the company is not bound to redeem and the holder has no right to demand redemption, or it may mean that though the holder cannot force the company to redeem. the company may at its pleasure if it so desires redeem same at any time. Of course these irredeemable debentures become immediately payable either when the company goes into liquidation, or in the event of its interest falling in arrear. This is the case even though the liquidation may be for the purpose of reconstruction or amalgamation, and even though there may be an express provision to the contrary (*Re. Crompton & Co.,* (1914) 1 *Ch.* 954).

MORTGAGE OR CHARGE

With regard to the mortgage or charge created on the debentures it is provided for by the Indian Companies Act that proper particulars as to every such mortgage or charge together with instruments, if any, by which the mortgage or charge is created or evidenced, or a copy

thereof verified in the prescribed manner, should be filed with the registrar for registration within twenty-one days after the date of creation. If this is not done, the said mortgage or charge shall be void against the liquidator or any of the creditors (Sec. 109). In *in re. Monolithic Building Co., Tacon* v. *The Company,* (1915) 1 *Ch. D.* 643, it was laid down that Sec. 93 (our corresponding Sec. 109) of the Companies (Consolidation) Act 1908, avoids an unregistered mortgage as against a subsequent registered incumbrancer even though he had express notice of the prior mortgage at the time when he took his own security. In a Bombay case *D. Pudumji & Co.* v. *N. H. Moos,* (1925) 27 *Bom. L. R.* 1925, where the sole managing director of a private limited company borrowed a sum on condition that "pending the execution of the mortgage deed the borrowers put the lender in possession of all property of the borrowers made up of printing machinery, papers and other moveable property of a newspaper printing concern and the directors of the borrowers shall hold possession of same as agents of the lender and shall not sell the same without consent of the lender" it was held that here the parties did not create a pledge, but intended to create a floating charge on the moveable property under the meaning of Sec. 109 and therefore the charge was void for want of registration. In another case where a company carrying on business as merchants consigned goods overseas and obtained advances from their bankers and wrote to them enclosing for the banker's acceptance the company's drafts drawn on these shipments and copies of bills of lading and invoices stating that the company hypothecated the goods or proceeds to the said bankers, it was held that the effect of the transaction was that the company had created a charge on the company's book debts, which charge not having been registered was void against liquidators (*Ladenburg & Co.* v. *Goodwin Ferreira & Co.,* (1912) 3 *K. B.* 275). In case however, the debentures are issued in a series in which reference is given to any

mortgage or charge, or to any other instrument giving such a mortgage, to which debenture holders of that series are entitled *pari passu,* the particulars as to the amount secured by the whole series, date of the resolution authorising the issue and the date of the covering deed, if any, by which the security is created or defined, a general description of the property charged and the names of the trustees, if any, for the debenture holders together with the deed or a copy thereof verified in the prescribed manner containing the charge or if there is no such deed, one of the debentures of the series, should be registered with the registrar (Sec. 110). In case a company issues debentures at a discount under its general powers provided there is nothing in the regulations or memorandum to prevent same (*Re. Anglo-Danubian Co.*, (1875) 20 *Eq.* 339; *Regents Canal Ironworks Co.,* (1876) 3 *Ch. D.* 43). In case any commission, bonus, or discount has to be paid directly or indirectly in connection with the issue of these debentures, the particulars of such discount, or commission, or allowance payable as to the amount or rate per cent. should also be included in the particulars supplied to the registrar for registration (Sec. 111). When two or more series of debentures are issued giving a floating charge and there is nothing to show that they are to rank *pari passu* they will rank according to the date of issue (*James* v. *Boythorpe Colliery Co.,* (1890) *W. N.* 289; *Gartside* v. *Silkstone Coal Co.,* (1882) 21 *Ch. D.* 762).

Charges to be Registered

In this connection Sec. 109 of the Indian Companies Act is very important.

Sec. 109 (*1*) :—Every mortgage or charge created after the commencement of this Act by a company and being either :—

(*a*) a mortgage or charge for the purpose of securing any issue of debentures; or

(*b*) a mortgage or charge on uncalled share capital of the company; or

(*c*) a mortgage or charge on any immovable property wherever situate, or any interest therein; or

(*d*) a mortgage or charge or any book debts of the company;

(*e*) *a mortgage or charge not being a pledge on any movable property of the company except stock-in-trade;* or

(*f*) a floating charge on the undertaking or property of the company;

shall, so far as any security on the company's property or undertaking is thereby conferred, be void against the liquidator and any creditor of the company, unless the prescribed particulars of the mortgage or charge, together with the instrument (if any) by which the mortgage or charge is created or evidenced, or a copy thereof verified in the prescribed manner are filed with the registrar for registration in manner required by this Act within twenty-one days after the date of its creation, but without prejudice to any contract or obligation for repayment of the money thereby secured. and when a mortgage or charge becomes void under this section, the money secured thereby shall immediately become payable :—

Provided that :—

(*i*) in the case of a mortgage or charge created out of British India comprising solely property situate outside British India, twenty-one days after the date on which the instrument or copy could, in due course of post, and if despatched with due diligence, have been received in British India shall be substituted for twenty-one days after the date of the creation of the mortgage or charge, as the time within which the particulars and instrument or copy are to be filed with the registrar; and

(*ii*) where the mortgage or charge is created in British India but comprises property outside British India, the instrument creating or purporting to create the mortgage or charge or a copy thereof verified in the manner may be filed for registration notwithstanding that further proceedings may be necessary to make the mortgage or charge valid or effectual according to the law of the country in which the property is situate; and

(*iii*) where a negotiable instrument has been given to secure the payment of any book debts of a company, the deposit of the instrument for the purpose of securing an advance to the company shall not, for the purposes of this section, be treated as a mortgage or charge on those book debts; and

(*iv*) the holding of debentures entitling the holder to a charge on immovable property shall not be deemed to be an interest in immovable property.

(2) Where any mortgage or charge on any property of a

company required to be registered under this section has been so registered, any person acquiring such property or any part thereof or any share or interest therein shall be deemed to have notice of the said mortgage or charge as from the date of such registration.

The above S. 109 (1) (e) now makes it compulsory for every mortgage on movable property as distinguished from a pledge, to be registered which was not the case under the old Act, whereas S. 109 (2) is designed to affect transferees with notice as from the date of registration. After the commencement of the Amendment Act a company registered in British India acquires any property subject to a charge of any kind as would if it had been created by the company after the acquisition same had been required to be registered under S. 109 the company must cause the prescribed particulars of the charge, together with a copy (certified in the prescribed manner to be correct copy) of the instrument, if any, by which the charge was created or is evidenced, to be delivered to the registrar for registration in manner required by this Act within twenty-one days after the date on which the acquisition is competed. Where however the property is situate and the charge was created outside India, twenty one days after the date on which the copy of the instrument could in due course of post, and if despatched with due diligence, have been received in British India shall be substituted for twenty-one days after the completion of the acquisition as the time within which the particulars and the copy of the instrument are to be delivered to the registrar. In case of default the company and every officer of the company who is knowingly and wilfully in default shall be liable to a fine of five hundred rupees (S. 109A).

In this connection the provision of Sec. 120 is important. The section here provides a remedy in cases where the omission to register a mortgage within the twenty-one days prescribed is accidental or due to inadvertence or due to some other sufficient cause. The section runs as under :—

Sec. 120 :—The Court, on being satisfied that the omission to register a mortgage or charge within the time required by Section

109, or that the omission or misstatement of any particular with respect to any such mortgage or charge, *or the omission to give intimation to the registrar of the payment or satisfaction of a debt for which a charge or mortgage was created,* was accidental, or due to inadvertence or to some other sufficient cause, or is not of a nature to prejudice the position of creditors or shareholders of the company, or that on other grounds it is just and equitable to grant relief, may, on the application of the company or any person interested and on such terms and conditions as seem to the Court just and expedient, order that the time for registration be extended or, as the case may be, that the omission or misstatement be rectified, and may make such order as to the costs of the application as it thinks fit.

(2) *Where the Court extends the time for the registration of a mortgage or charge, the order shall not prejudice any rights acquired in respect of the property concerned prior to the time when the mortgage or charge is actually registered.*

Here the words of the section are no doubt very wide but the exercise of powers under it is discretionary (*Abrahams & Sons,* (1902) 1 *Ch.* 695; *Johnson & Co., Ltd.,* (1902) 2 *Ch.* 101). When relief is given under this section, the English Courts add the words as "This order to be without prejudice to the rights of parties registered prior to the time when such mortgage shall be actually registered" (*Re. Joplin Brewery Co.,* (1902) 1 *Ch.* 79). This order protects the rights acquired against the property of the company in the interval between the expiration of the twenty-one days for registering and the extended time which is now allowed by this order. The other addition is that if liquidation supervenes before registration, the order gives no advantage to the existing creditors which have not levied execution or taken some other step to enforce their debts before the registration of the charge (*Ehrmann Bros. Ltd.,* (1906) 2 *Ch.* 697).

A subsequent creditor who obtains a registered charge after expiry of the specified time in the above form, gets priority over the first charge registered under the order of the Court after the expiry of the time (*Tacon* v. *Monolithic Building Co.,* (1915) 1 *Ch.* 643). If a mortgage or charge is registered under the above order after winding

up has commenced, it is ineffective, against the unsecured creditors (*Anglo-Oriental Carpet Co.*, (1903) 1 *Ch.* 914). When the registrar is satisfied on evidence given to his satisfaction that the debts for which any mortgage or charge was registered has been paid or satisfied, may order that a memorandum of satisfaction be entered on the register and shall if required furnish the company with a copy thereof (Sec. 121). It must be noticed that the registration of the mortgage or charge is optional and may be effected at any time. If such a satisfaction were entered by mistake or under misapprehension in the register, the same may be cancelled under Sec. 120 (*Re. Light & Co.*, (1917) 61 *Solicitors Journal* 337). If an agreement is entered into to issue debentures in case of certain contingencies and there is no charge until the contingency occurs even than it must be seen that the agreement was registered. In this case there was right to a floating charge not as at the date of the agreement, but on the occurrence of certain events (*Gregory Love & Co.*, (1916) 1 *Ch.* 203).

Where uncalled share capital of the company is mortgaged the particulars of such a mortgage or charge must be registered with the registrar. On the same footing particulars of mortgage, including mortgages created by a mere deposit of title deeds without a memorandum, by a company of its immovable property wherever situate or interest thereof, must be registered with the registrar of joint stock companies independently of any registration that may be made under the Indian Registration Act of 1908. With reference to book debts not only the present book debts, but also the future book debts can be charged (*Official Receiver* v. *Tailby,* (1886) 18 *Q. B. D.* 29). For this purpose a bill of exchange actually entered in the company's book has been declared to be a book debt (*Dawson* v. *Isle,* (1906) 1 *Ch.* 633). In case of a director of a company he can lend money to the company on a debenture issued at a discount, provided he is so doing for the benefit of the company and is not prohibited by statute or the articles of the company from advancing

that loan (*Campbell's Case,* (1877) 4 *Ch. D.* 470). A trader also who sells his business to the company may receive debentures charging all the assets of the company in satisfaction of the whole or part of its purchase money (*Salomon* v. *Salomon & Co.,* (1897) *A. C.* 22). If the directors are given power to borrow on debentures after a certain proportion of share capital has been subscribed and any debentures are issued before such subscription, the same would be invalid (*West Cornwell Rail Co.* v. *Mowatt,* (1848) 17 *L. J. Ch.* 366). Even where a temporary loan is made to bankers by the company upon the security of its uncalled capital and the charge is made by a resolution of the board, *i.e.,* by parole, it is good, subject to registration under Sec. 109 of the Indian Companies Act (*Re. Tilbury Portland Cement Co.,* (1893) 62 *L. J. Ch.* 814). It should be however remembered in connection wit' charge on uncalled capital that a company whose liability is limited by guarantee cannot charge the amounts guaranteed by members to be contributed in the event of a winding up (*Re. Irish Club Co. Ltd.,* (1906) *W. N.* 127).

It should however be remembered that debentures whether redeemable or not if they are to be allotted for a consideration other than cash they are to be stated in the prospectus [Sec. 92 (g)].

Registration of Mortgage or Charge by Debentures

The registrar, as provided for by Sec. 114, shall give a certificate under his hand of the registration of any mortgage or charge registered in pursuance of Sec. 109 stating the amount thereby secured and the certificate shall be conclusive evidence that the requirements of Secs. 109-112 as to registration have been complied with.

To quote these secitons *in extenso,* Sec. 110 deals with the question as to how particulars of a series of debentures are to be registered. The section runs as follows :—

"Where a series of debentures containing, or giving by reference to any other instrument, any charge to the benefit of

which the debenture-holders of that series are entitled *pari passu* created by a company, it shall be sufficient for the purposes of Sec. 109 if they are filed with the registrar within twenty-one days after the execution of the deed containing the charge or, if there is no such deed, after the execution of any debentures of the series, the following particulars :—

(*a*) the total amount secured by the whole series; and

(*b*) the dates of the resolutions authorising the issue of the series and the date of the covering deed (if any) by which the security is created or defined; and

(*c*) a general description of the property charged; and

(*d*) the names of the trustees (if any) for the debenture-holders; together with the deed or a copy thereof verified in the prescribed manner containing the charge, or if there is no such deed, one of the debentures of the series, and the registrar shall, on payment of the prescribed fee, enter those particulars in the register;

Provided that, where more than one issue is made of debentures in the series, there shall be filed with the registrar for entry in the register particulars of the date and amount of each issue, but an omission to do this shall not affect the validity of the debentures issued.

Section 111 further requires that in case where any commission, allowance or discount is paid, the particulars of same must also be registered. This section runs as follows :—

"Where any commission, allowance or discount has been paid or made either directly or indirectly by the company to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any debentures of the company, or procuring or agreeing to procure subscriptions, whether absolute or conditional, for any such debentures, the particulars required to be filed for registration under Secs. 109 and 110 shall include particulars as to the amount or rate per cent. of the commission, discount or allowance so paid or made, but an omission to do this shall not affect the validity of the debentures issued;

Provided that the deposit of any debentures as security for any debt of the company shall not for the purposes of this provision be treated as the issue of the debentures at a discount."

Registrar's Register of Mortgages and Charges

In this connection Sec. 112 lays down that the registrar shall keep with respect of each company a register in the

prescribed form of all mortgages and charges created by the company after the commencement of the Act of 1913 and requiring registration under Sec. 109 and shall on payment of the prescribed fee enter in the register with respect to every such mortgage or charge, the date of creation, the amount secured by it, short particulars of the property mortgaged or persons entitled to the charge. Having made these entries in his register of mortgages, the registrar shall return the instrument, if any, or verified copies thereof as the case may be, filed in accordance with Sec. 109 or Sec. 110 to the person filing same. This register shall be open to the inspection by any person on payment of the prescribed fee not exceeding Re. 1 for each inspection. The registrar has to keep a chronological index in the prescribed form and with prescribed particulars of the mortgages and all charges registered with him under the Indian Companies Act, 1913 (Sec. 113). A further enactment is that the company shall cause a copy of every certificate of registration given by the registrar under Sec. 114 to be endorsed on every debenture or certificate of debenture stock which is issued by the company and the payment of which is secured by the mortgage or charge so registered. This of course does not apply to certificates of debenture or debenture stock which have been issued before such mortgage or charge was created (Sec. 115). It is of course the duty of the company to file with the registrar for registration the prescribed particular of every mortgage or charge created by the company and of the issues of debenture of a series requiring registration under S. 109. When the company fails to register the mortgage or charge, as it is his duty under the Act to do, any person interested may apply for such registration to the registrar and in that case such person will be entitled to recover from the company the amount of any fees properly paid by him to the registrar on registration. *Whenever the terms or conditions or extent or operation of any mortgage or charge registered under this section are modified, it shall be the duty of the company to send to the registrar the*

particulars of such modification on the same footing as provided in case of mortgages and charges requiring registration (Sec. 116). The further requirement is that in case of those mortgages and charges which are required to be registered under Sec. 109, the company shall cause a copy of every instrument creating any mortgage or charge under this section to be kept at its registered office except in case where a series of uniform debentures have been issued where a copy of one such debenture shall be sufficient (Sec. 117). Here it should be noted that what is required is copies of those types of mortgages and charges only, which are detailed in Sec. 109, are required and the regulation does not apply to those that do not fall under that section. If any person obtains an order for the appointment of a receiver of the property of a company, or appoints such a receiver under any powers contained in any instrument, he shall, within fifteen days from the date of the order or of the appointment under the powers contained in the instrument, file notice of the fact with the registrar, and the registrar shall, on payment of the prescribed fee, enter the fact in the register of mortgages and charges. If any person makes default in complying with the requirements of this section, he shall be liable to a fine not exceeding fifty rupees for every day during which the default continues (S. 118). Besides this where the receiver of the property of a company who has been appointed under the powers contained in an instrument and who has taken possession, shall once in every half year while he remains in possession and also on ceasing to act as a receiver file with the registrar an abstract in the prescribed form, of his receipts and payments during the period to which the abstract relates and shall on ceasing to act as receiver file with the registrar a notice to that effect. The registrar is here required to enter this notice in the register of members and charges. *Where a receiver of the property of a company has been appointed, every invoice, order for goods or business letter issued by or on behalf the company or the receiver of the company, being a document on or in which*

the name of the company appears shall contain a statement that a receiver has been appointed. In case of default, the company and every director, manager, managing agent, secretary or other officer of the company and every receiver who knowingly and wilfully authorises or permits the default shall be liable to a fine not exceeding two hundred rupees (*S.* 119).

With reference to registration of particulars as to mortgage and charges created by the company for the issue of debentures of a series, Sec. 122 further lays down the penalties as follows :—

"If any company makes default in filing with the registrar for registration the particulars :—

(*a*) of any mortgage or charge created by the company, or

(*b*) *of the payment or satisfaction of debt in respect of which a mortgage or charge has been registered under S. 109 or S. 109A; or*

(*c*) of the issues of debentures of a series, requiring registration with the registrar under the foregoing provisions of this Act, then, unless the registration has been effected on the application of some other person, the company, and every officer of the company or other person who is knowingly a party to the default, shall on conviction be liable to a fine not exceeding five hundred rupees for every day during which the default continues.

Subject as aforesaid, if any company makes default in complying with any of the requirements of this Act as to the registration with the registrar of any mortgage or charge created by the company, the company, and every officer of the company who knowingly and wilfully authorises or permits the default shall, without prejudice to any other liability, be liable on conviction to a fine not exceeding one thousand rupees.

If any person knowingly and wilfully authorises or permits the delivery of any debenture or certificate of debenture stock requiring registration with the registrar under the foregoing provisions of this Act without a copy of the certificate of registration being endorsed upon it, he shall, without prejudice to any other liability, be liable on conviction to a fine not exceeding one thousand rupees.

Registration of Satisfaction of Mortgages and Charges

Though Section 121 of the Old Act empowered the registrar to register satisfaction of mortgage on proof of

such satisfaction of the mortgage or charge this was not done which caused confusion and made the record unsatisfactory. Now it is laid down that *it shall be the duty of the company to give intimation to the registrar of the payment or satisfaction of any charge or mortgage created by the company and requiring registration under S. 109 within twenty-one days from the date of the payment or satisfaction thereof. The registrar on receipt of such intimation must cause notice to be sent to the mortgagee calling upon him to show cause, within a time (not exceeding fourteen days) to be fixed by such notice, why the payment or satisfaction of the charge or mortgage should not be recorded and if no cause is shown order a memorandum of satisfaction to be entered on the register and if required he must furnish the company with a copy of same. If cause is, shown the registrar must record a note to that effect in the register, and inform the company that he has done so (S. 121).*

Company's Register of Mortgage

Every limited company must keep a register of mortgages and enter therein all mortgages and charges specifically affecting the property of the company *and all floating charges on the undertaking or on any property of the company* giving in each case short description of the property mortgaged or charged, the amount of the mortgage or charge and (except in the case of securities to bearer) the names of the mortgagees or persons entitled thereto. Any director, manager or other officer of the company knowingly or willingly authorising or permitting the omission of any entry required to be made in pursuance of this section is liable to a fine not exceeding Rs. 500 (S. 123). Non-registration under this section will not affect the validity or priorities of the mortgages or charges (*Wright* v. *Horton*, (1887) 12 *A. C.* 371; *General South American Co.*, (1876) 2 *Ch. D.* 337). The register is open to inspection of the public, besides this a copy is kept at the registered office of the company of instruments creating

mortgage or charge in pursuance of Sec. 117 must also be open to the inspection of the public at all reasonable times; this inspection is to be given to any creditor or member of the company without fee and to others on payment of a fee not exceeding one rupee for each inspection (Sec. 124). Under the same section if inspection is refused the company is liable to a fine not exceeding Rs. 50 and a further fine not exceeding Rs. 20 for every day during which the refusal continues. Every officer of the company who knowingly authorises or permits the refusal shall also incur a like penalty. The Court may compulsorily order an immediate inspection of the register. It has been also held that a solicitor of the creditor or shareholder may inspect this register (*Re. Credit Co.,* (1879) 11 *Ch. D.* 256). In this case it has been held that the right to inspect the register of mortgages and charges includes the right to take copies (*Nelson* v. *Anglo-American Land Co.,* (1897) 1 *Ch.* 130). If inspection is required during winding up, the same can be obtained by an order of the Court under Sec. 241 (*Somerset* v. *Land Securities Co.,* (1897) *W. N.* 29). This Sec. 241 lays down that in case of compulsory winding up or winding up under the supervision of the Court, the Court may make such order for inspection by creditors and contributories of the company of its documents as the Court thinks just and any documents in the possession of the company may be inspected by creditors or contributories accordingly, but not further or otherwise. The liquidator in connection with this inspection cannot pledge the party concerned to obtain copies on payment (*Arauco & Co., Re.,* (1899) *W. N.* 134). Even where there are clauses in the articles regulating the right of inspection, the same ceases to operate on winding up (*Yorkshire Fibre Co.,* (1870) 9 *Eq.* 650). They would only operate if the winding up is for re-construction (*Metropolitan & Provincial Bank,* (1868) 16 *W. R.* 668). This inspection is allowed for the benefit of those who are interested in winding up and not for the purpose of enabling individual shareholders to establish claims for their personal benefit

(*North Brazilian Sugar Factories*, (1887) 37 *Ch. D.* 83; *Morgan's Case*, (1884) 28 *Ch. D.* 620). The giving of this order in winding up is of course at the discretion of the Court with which the Appeal Court will not interfere, unless the order is clearly wrong (*Lancashire Cotton Spinning Co.* v. *Greatorex*, (1886) 14 *L. T.* 290).

The company's register of mortgages and charges would be maintained in the form given hereunder.

The Indian Companies Act does not make the maintenance of a register of debenture-holders compulsory, as distinct from the register of mortgages, though the articles of association generally provide for same. The form to be presented to the registrar with a view to give him particulars of the mortgages and charges is as follows :—

FORM IX

PARTICULARS OF MORTGAGES & CHARGES.

The Indian Companies Act, 1913.

Fee payable in accordance with rule.

Particulars to be filed with the registrar pursuant to Sec. 109 of a mortgage or charge created by the . . . . (name of the company) and being :—

FORM OF
REGISTER OF MORTGAGES AND CHARGES AND OF MEMORANDUM OF SATISFACTION OF A. B. C. LTD.

(1)	(2)	(3)	(4)	(5)	(6)	(7)	Particulars relating to the issue of Debentures of a Series							(14)	(15)	(16) Receiver or Manager	
							(8)	(9)		(10)	(11)	(12)	(13)				
Date of Registration	Serial Number of Document on File	Date of Creation of each Mortgage or Charge and Description thereof	Date of the acquisition of the Property	Amount secured by the Mortgage or Charge	Short particulars of the Property mortgaged or charged	Names of the Mortgagees or Persons entitled to the Charge	Total amount secured by a series of Debentures	Date and Amounts of each issue of the series		Dates of the Resolutions authorising the issue of the...series	Date of the Covering Deed	General Description of the Property charged	Names of the Trustees for the Debenture-holders	Memorandum of Satisfaction—(Amount)	Amount or Rate per cent. of the......Commission, Allowance or Discount	Name and Date of Appointment	Date of ceasing to act.
								Date	Amount								
				Rs.			Rs.		Rs.					Rs.			

(*a*) A mortgage or charge for the purpose of securing any, issue of debentures; or

(*b*) A mortgage or charge on uncalled share-capital of the company; or

(*c*) A mortgage or charge on any immovable property wherever situate or any interest therein; or

(*d*) A mortgage or charge on any book debts of the company;

(*e*) A mortgage or charge, not being a pledge on any movable property of the company except stock-in-trade, or

(*f*) A floating charge on the undertaking or property of the company.

(Strike out the sub-heads (a), (b), (c), (d) (e) or (f) which do not apply).

Presented for filing by

Particulars of mortgage or charge created by the

1	2	3	4	5
Date of the instrument creating or evidencing the mortgage or charge and description thereof.	Amount secured by the mortgage or charge.	Short particulars of the property mortgaged or charged.	Names (with addresses and descriptions) of the mortgagees or persons entitled to the charge.	Amount or rate per cent of the commission, allowance or discount (if any) paid or made either directly or indirectly by the company to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditional or procuring or agreeing to procure subscriptions whether absolute or conditional for any of the debenture included in this Return.

Designation or position in relation to the company. *Signature.*

Date.

If however such a register of holders of debentures is maintained, Sec. 125 makes it compulsory that the same except when closed in accordance with articles during such period or periods not exceeding on the whole thirty days in any year be open to the inspection of the registered holder of any such debentures and of any holder of shares in the company. This is however to be done subject to such reasonable restrictions as the company may in general meeting impose so that at least two hours in each day are appointed for inspection and every such holder may require a copy of the register or any part thereof on payment of annas six for every hundred words or fractional part thereof required to be copied. If any holder of debentures requires a copy of the trust-deed for securing such an issue, the same shall be forwarded on request on payment, in case of a printed copy, of the sum of one rupee or such less sum as may be prescribed by the company or if the trust-deed has not been printed, on payment of six annas for every hundred words or fractional part thereof required to be copied. If the inspection of these registers or the furnishing of copies is refused the company is liable to a fine not exceeding fifty rupees and to a further fine not exceeding twenty rupees for every day during which the refusal continues. Every officer of the company also who knowingly authorises or permits the refusal shall incur the like penalty and the Court may by order compel an immediate inspection of the register.

FLOATING AND FIXED CHARGES

The charge created in connection with the issue of debentures may be either a floating charge or a fixed charge. We shall deal with these two types of charges in detail under separate headings :—

FORM OF
DEBENTURE-HOLDER'S REGISTER

Name.......................... Address............................ Description......................

Debentures Acquired										Debentures Disposed of								
Date	No. of Allotment Letter or Transfer Deed	Name of Transferor	Ledger Folio	No. of Bonds or Certificates	Distinctive Numbers of Bonds		Value			Date	No. of Transfer	Name of Transferee	No. of Bonds or Certificates	Distinctive Numbers of Bonds		Value		
					From	To	Rs.	a.	p.					From	To	Rs.	a.	p.

The Floating Charge

We have already alluded to the position of debentures giving a floating charge in brief. According to *Lord Macnaghten* in the *Govt. Stock Investment Co.* v. *Manila Ry. Co.,* (1897) *A. C.* 81, " A floating security is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is of the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes (*Evans* v. *Rival Granite Quarries Ltd.,* (1910) 2 *K. B.* 979). His right to intervene may of course be suspended by agreement. But if there is no agreement for suspension, he may exercise his right whenever he pleases after default." Thus it will be noticed that the floating charge leaves the company free to deal with its assets until the right of the creditor to interfere is crystallised as in case of default or liquidation (*Florence Land Co.,* (1878) 10 *Ch. D.* 530; *Re. Standard Mfg. Co.,* (1891) 1 *Ch.* 627; *Foster* v. *Borax Co.,* (1901) 1 *Ch.* 326; *Hubbuck* v. *Helms,* (1887) 56 *L. T.* 232; *Nelson & Co.* v. *Faber & Co.,* (1903) 2 *K. B.* 367; *Hamer* v. *London City & Midland Bank,* (1918) 118 *L. T.* 571). Until that happens, however, the property may be sold or specifically mortgaged. There is however no objection to the creation of a second floating charge, *under powers expressly reserved,* over any part of those assets ranking *pari passu* with or in priority to the earlier floating charge (*In re. Automatic Bottle Makers Ltd.; Osborne* v. *Automatic B. Makers,* (1926) 1 *Ch. D.* 412). A charge will be treated as a floating charge if it is created on part only of the property with a view to effectuate the intention, expressed or implied (*Illingworth* v. *Houldsworth,* (1904) *A. C.* 355).

In a Bombay case the *Bank of Baroda* v. *H. B. Shivdasani,* (1926) 50 *Bom. L. R.* 547, where a mill company borrowed on the pledge of " all the liquid assets including stock-in-process now or at any time hereafter stored

by the company in the godowns and the mill premises" with the condition that the company was not to pledge or otherwise charge or encumber the pledged goods which were to be kept in a godown, the keys of which were delivered to the lending bank, which lending bank was to sell the goods under certain conditions, it was held that the transaction did not create a floating charge, but amounted to a mortgage of specific assets with a license to the company to dispose them in the course of its business subject to prescribed conditions.

It may be added that in interpreting the clauses in the debenture deeds laying down the circumstances under which the charge becomes enforceable the Court in case of goods dealt in, or required for the purpose of business, will always be inclined to the view against their being treated as fixed mortgage (*Evans* v. *Rival Granite Quarries Ltd.,* (1910) 2 *K. B.* 979. *See other cases cited there in judgments of Vaughan Williams; Moulton; Buckley, L. Js.*). There are certain creditors, however, who have priority even to the rights of debenture-holders on a floating charge, *e.g.,* the landlord who distrains for rent due. We have already seen that the floating charge must be registered on the same footing as the fixed charge or mortgage. Not only can the company sell away assets on which a floating charge by debentures is secured, but in case the business of a company is carried on through means of branches, it can sell the entire business of a complete branch (*Metropolitan Bank of England and Wales* v. *Vivian & Co.,* (1900) 2 *Ch. D.* 654). *In Re. Borax Co.,* (1901) 1 *Ch. D.* 326, where the memorandum of association of a company authorised amalgamation, union, as well as sale, of all or any part of the company's business, or property, as well as holding of debentures and shares of other companies, and the company sold the whole of its property and assets, including the good will, to a new company, but retained certain securities and in return received from the new company its debenture-stock and shares, and further agreed not to carry on any similar business except in con-

junction with and for the benefit of the new company, it was held that as the sale was within the powers of the company, according to its memorandum and as the old company had not ceased to exist, the debenture-holders' charge was nothing more than a floating security. Thus the principle here enunciated results in this that, in case if the company sells the whole of its assets or undertaking, but does not technically cease to exist, the floating debenture-holders can claim no right of interference. If the debenture-holders wish to prevent their securities from being destroyed by subsequent fixed charges or mortgages being created, they ought to protect themselves by inserting special provisions to that effect in the instrument creating the charge on behalf of debenture-holders. According to *Romer, L.J.*, *in re. Yorkshire Woolcombers' Association Limited*, (1903) 2 *Ch. D.* 284, a charge is a floating charge if it contains the following three elements, *viz.*, (1) if it is a charge on a class of assets of a company present and future; (2) if that class is one which in the ordinary course of the business of the company, would be changing from time to time, and (3) if you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way. If, however, the goods secured by floating debenture-holders are seized by the sheriff, the debenture-holders can claim priority for the rights of execution creditors (*Davey & Co.* v. *Williamson & Sons,* (1898) 2 *Q. B. D.* 194). In this case it was laid down (1) that seizure of the goods by the sheriff is not dealing with it in the ordinary course of the business, but that, it was a compulsory legal process directed against the company; and (2) that the rights of debenture-holders as the goods were validly charged prevailed against the execution creditors with the payment of the amount of debentures. This priority existed not only with regard to the legal, but also to the equitable rights. They are thus entitled to say to the sheriff " the goods seized are validly charged to us and you cannot sell them to the prejudice

of our security." It should however be noted that preferential and priority of payments as reserved by Sec. 230 refer only to the fund available as assets after the claims of secured creditors are satisfied (*Raja Bahadur Motilal Shivlal* v.*The Poona Cotton & Silk Mafg. Co., Ltd.,* (1918) 42 *Bom. L. R.* 215 at p. 220).

When a charge is expressed to be on the "undertaking" of a company, the word undertaking means all the property present and future, but it does not include uncalled capital (*In re. Panama Newzealand Co.,* (1870) *L. R.* 5 *Ch. Ap.* 318; *Johnson* v. *Russian Spratt's Patents, Ltd.,* (1898) 2 *Ch.* 149). A mortgage or charge of a particular class of property only may be taken as a floating charge, in case it is a charge on a class of assets both present and future which class is one which in the ordinary course of the business of the company may be changing from time to time and when it appears from the construction of the documents and circumstances that until some future step is taken by and on behalf of the mortgagee, a company can carry on its business in the ordinary way as far as that particular class of assets is concerned (*Houldsworth* v. *Yorkshire Woolcombers' Association,* (1903) 2 *Ch.* 284 *affirmed in* 1904 *A. C.* 355; *Pudumjee & Co.* v. *Moos,* (1925) 27 *Bom. L. R.* 1218; *National Provincial Bank* v. *United Electric Theatres Limited,* (1916) 1 *Ch.* 132). In case of a company having several branches it is not precluded by the floating charge from selling the whole of business of one branch (*Metropolitan Bank of England & Wales* v. *Vivian & Co.,* (1900) 2 *Ch.* 654). In one case it was also held that even the whole undertaking of the company can be sold in spite of floating charge, provided such sale is within the powers contained in the memorandum of association (*Re. Borax Co.,* (1901) 1 *Ch.* 326). We have seen that the floating charge crystallises on liquidation even though the liquidation may be simply for the purpose of re-construction but here the exception is that if the provisions of the debenture or debenture deed stipulate to the effect that a floating charge will not crystallise in

case of liquidation for the purpose of construction, that provision would be binding (*Player* v. *Crompton & Co.*, (1914) 1 *Ch.* 954). However, it must be remembered that the charge does not crystallise only because something has happened such as the non-payment of interest in time, unless and until the debenture-holders have taken the necessary action such as an application to the Court for the appointment of a receiver or otherwise, or for the realisation of securities (*Edward Nelson & Co.* v. *Fabre*, (1903) 2 *K. B.* 367; *Evans* v. *Rival Granite Quarries*, (1910) 2 *K. B.* 979). In this case *Fletcher Moulton, L. J.*, states on page 993 that " mere default on part of the company does not change the character of the security, the debenture-holder must actually intervene." In the words of *Buckley, L. J.*, at page 1002 " no equity arises in a debenture-holder whose security is a floating charge from his merely giving notice to seize a particular asset of the company. He must do something to turn his security from a floating into a fixed charge." It will thus be seen that some action has to be taken by the debenture-holder on the happening of the incident which entitles him to get his charge crystallised into a fixed charge before the said charge actually gets crystallised. If he does not do so the company can in the interval deal with the property and the persons who get interested in same would have the prior right (*Re. Ind. Coope & Co. Ltd.*, (1911) 2 *Ch.* 223).

The construction of the document giving the charge will decide the question whether a subsequent charge or mortgage will affect the security of the first floating charge (*In re. Benjamin Cope & Sons*, (1914) 1 *Ch.* 800; *Re. Automatic Bottle Makers*, (1926) 1 *Ch.* 412). Where however such a clause or condition is clearly inserted in the mortgage that will not prevent a sale (*Coveney* v. *Persse*, (1910) 1 *Ir. R.* 194). The security may here still be defeated by execution by a garnisher or distress by a landlord or a lien of a solicitor (*Evans* v. *Rival Granite Quarries*, (1910) 2 *K. B.* 979; *Roundwood Colliery Co.*, (1897) 1 *Ch.* 373; *Brunton* v. *Electrical Engineering*

Corporation, (1892) 1 *Ch.* 434. A subsequent mortgagee who did not know of the earlier charge may complete his title by taking legal steps and thereby secure a priority (*English & Scottish Trust* v. *Brunton,* (1892) 2 *Q. B.* 1, 700). The same would be the case if he did not know that the earlier floating charge included a covenant forbidding the creation of a prior specific mortgage (*Standard Rotary Machine Co.,* (1906) 95 *L. T.* 829; *Valletort Laundry Co.,* (1903) 2 *Ch.* 654). In one case where a floating charge was created on the general assets of the company and a subsequent equitable charge was effected in favour of bankers by deposit of title deeds, it was held that it was a good mortgage which had a prior claim and was not subject to the claim of floating charge created on debentures (*Wheatley* v. *Silkston &c. Coal Co.,* (1885) 29 *Ch. D.* 715; *Government Stock & Invt. Co.* v. *Manila Railway Co.,* (1897) *A. C.* 81; *Re. Castell & Brown Ltd.,* (1898) 1 *Ch.* 315). In this case the words "first charge" were used in connection with debentures and in spite of that the learned judge *North, J.,* held as above because he said that this first charge "referred to in the debentures is fully satisfied by being the first charge against the general property of the company at the time when the claim under the debentures arose." Where a specific charge is made and it is expressly stated that the said specific charge is subject to a floating charge in that case a specific charge is postponed as from the date when the floating charge becomes crystallised by the appointment of a receiver (*In re. Robert Stephenson & Co., Ltd.,* (1913) 107 *L. T.* 33). A subsequent specific mortgage is not postponed by a notice of the floating charge (*Hamilton's Windsor Iron Works,* (1879) 12 *Ch. D.* 707).

It has been held that taking a second series of debentures in which a reference is made to a first series of debentures is not notice of the contents of the said first series with a view to fix the holder of the second series with notice of the contents of the first (*Valletort Laundry Co.,* (1903) 2 *Ch.* 654). Where a sheriff has taken goods

under execution and sold them, but the money is still in his hands, the floating debenture-holder can by taking immediate action enforce his security (*Re. Opera Ltd.*, (1891) 3 *Ch.* 260; *Taunton* v. *Sheriff of Warwickshire*, (1895) 2 *Ch.* 319). But if the property was not actually sold, but the company paid money to the sheriff against the decree with a view to induce him not to sell, the sheriff can retain same against the debenture-holders (*Robinson* v. *Burnell's Vienna Bakery*, (1904) 2 *K. B.* 624). Of course, if the security has crystallised before the sheriff sells the goods, the sheriff could be ousted according to the above case of *re. Opera Limited, etc.*

Usually, when large amounts of money are advanced, the practice is to take a fixed charge on immovable property and a floating charge on stock-in-trade, book debts, etc.

To sum up, the position of a floating charge is as follows :

(1) It operates as a continuing charge, but at the same time leaves the company free to deal with its property in the regular course of business subject to such restrictions as may be found in the instrument creating same.

(2) In spite of the floating charge the company is at liberty to make specific charges or mortgages even where the terms of the mortgage seem to give a priority to a subsequent floating charge.

(3) Until an execution creditor gets his property sold and receives cash proceeds of same from the sheriff, the floating debenture-holders can intervene with a view to crystallise their security but they shall have no right on cash paid to the sheriff by the company to prevent the execution property from being sold.

(4) A specific charge mortgagee is not postponed simply because he is aware of prior floating charge unless a specific clause in the instrument of mortgage provides for same.

(5) A floating charge remains a floating charge and only gets crystallised on the interest or capital falling in

arrears and the debenture-holders taking steps to crystallise their security or until the company goes into winding up. In winding up also if it is merely a winding up for reconstruction and the instrument creating the charge provides that the security shall not crystallise in case of such a winding up for reconstruction, the charge will not crystallise, the landlord can by distress get a priority over a floating charge before it crystallises.

The Fixed Charge

With regard to the charge it may be stated that a joint stock company, if it has the power, can mortgage its free-hold or lease-hold property in the same way as on ordinary person. It can also create a mortgage of its movable property on the same principle as an individual or a business man can. In case, however, where a large loan is raised by the issue of debentures, the holders of debentures are also given a fixed charge on some specific property of the company. For this purpose it is usual to have a trust-deed prepared, under which the free-hold or lease-hold property is specifically mortgaged and specially conveyed to trustees on behalf of the debenture-holders. The mortgage-deed gives powers to the persons named therein as trustees, of acting on behalf of the debenture-holders upon emergencies. The deed generally contains detailed conditions and stipulations safeguarding the interests of debenture-holders which cannot be done in case of debentures without a special trust-deed because in the latter case these conditions and stipulations would have to be endorsed or printed on the back of the debentures, which method hardly provides the requisite scope for inserting details. It must be further noted that when debentures are issued creating a charge, it should be clearly declared that each debenture of the series issued is to rank equally with the others of that series, otherwise the legal position will be that each of the series issued will have priority over those issued later (*Gartside* v. *Silkstone Co.*, (1882) 21 *Ch. D.* 762).

When a trust-deed is prepared, that generally gives power to the trustees to appoint receivers on the happening of a contingency. The contingencies on which this power is to be exercised are also specifically provided for in the deed. The question of the trust-deeds has been dealt with more fully in subsequent pages. In the absence of such specific power, application has to be made to the Court for the appointment of a receiver. This debenture trust-deed creating the mortgage or charge has of course to be registered (Sec. 109). As we have seen before, the registrar is required to keep with respect to each company a register in the prescribed form for all mortgages and charges created by the company required to be registered under Sec. 109. The registrar then gives a certificate of registration of this mortgage or charge a copy of which has to be endorsed by the company on every debenture or certificate of debenture stock issued by it (Secs. 114-115). It may further be added that these provisions of the Companies Act do not in any way affect the requirement for the registration of documents under the Indian Registration Act of 1908. Besides this, in accordance with the requirements of Sec. 123, every limited company must keep a register of mortgages and enter therein all mortgages and charges specifically affecting the property of the company *and all floating charges on the undertaking or on any property of the company,* giving in each case a short description of the property mortgaged or charged, the amount of mortgage or charge (except in the case of securities to bearer), the names of the mortgagees or persons entitled thereto. Failure to comply with the requirement of this section makes every director, manager or officer liable to a fine not exceeding Rs. 500. This register shall be open, at all reasonable times, to the inspection of any creditor or members of the company without fee, and in case of any other person a fee, not exceeding one rupee, for every inspection may be charged (Sec. 124). The trustees on behalf of the debenture-holders have to see that the documents of title, if any, on the securities mortgaged with the

debenture-holders are given to them and should carefully watch the interests of the debenture-holders. They must not allow the security of the debenture-holders to suffer in any way, and in case of a breach of any of the covenants of the trust, either through non-payment of interest at the appointed time, or failure to return the capital at the due date, or in any other case as provided for in the terms of the issue, they should act upon their powers reserved to them in the trust-deed. It is further provided that when a receiver is appointed in connection with the power contained in the instrument, the said receiver who has taken possession shall, once in every half year while he remains in possession, and also on ceasing to act as a receiver, file with the registrar an abstract in the prescribed form, of his receipts and payments during the said period to which the abstract relates, and as soon as he ceases to act as a receiver he must give notice to the registrar to that effect. The registrar then enters such a notice in the register of mortgages and charges (Sec. 119).

DEBENTURE TRUST-DEEDS

As we have seen previously it is now-a-days usual to have a trust instrument or trust-deed in connection with the issue of debentures with a view to secure them. This trust-deed, generally speaking, seeks to mortgage or charge certain specific property or gives a floating charge on general estate, or both, to the debenture-holders by way of security for the payment of debentures or debenture stock as well as interest on them on proper dates agreed upon between the parties. The usual practice is to secure the consent of two or more prominent persons well known to the debenture-holders to act as trustees on their behalf. These debenture trustees represent the lenders or the creditors who become mortgagees when the charge is given. These trustees of one part on behalf of the lenders and mortgagees and the company on the other part, enter into these trust-deed under which the company as the borrower shall convey its properties or charges in favour of the

trustees in connection with this security and the trust-deed is then made to embrace in detail the terms and conditions under which the loan has been given and the charges have been created. It also gives in detail under various clauses the rights of the debenture-holders, which they can exercise through their trustees in case of default, either in payment of interest or the repayment of capital or in case of liquidation.

The advantages of providing a trust-deed are many, the principal of which happens to be that in case of emergency as well as all throughout the period that the loan agreement is working, the debenture-holders have the trustees looking after their interest and ready to protect them whenever any event happens which is likely to threaten these interests. Besides this, in case of arrears of interest or capital or in the event of liquidation through the powers which are provided for in the trust-deeds, debenture-holders are able to get the properties sold or taken possession of as mortgagees through their trustees and to do this without having to resort to Court for assistance, as a mortgagee under ordinary mortgage which does not embrace these clauses has to do and which the debenture-holders in absence of a trust-deed may have to do themselves through the Court. If the charge on mortgage is given separately in separate debentures issued to each debenture-holders it is not very easy for them to take advantage of this position. The creation of this specific mortgage through the bringing in of trustees, places the debenture-holders in a more secure position and the trustees are able whenever necessary to consult the wishes of the debenture-holders through their meetings called by themselves. In cases where the position so requires the debenture-holders can through their trustee get a receiver of the mortgaged property appointed and that too under the powers in the deed without the intervention of the Court. The various clauses in the covenant or deed also binds the company down to various agreements under which they have to do or abstain from doing various things as the debenture-

holders interest may warrant. Of course, there were cases more frequent in old days than they are at present, where the financial position of the company borrowing being very sound, the security of the debenture trust-deed was not asked for, but now-a-days the debenture trust-deeds in case of large loans and for any specifically long period have become almost universal. In case of short loans from bankers and others, these deeds naturally are not generally used, though even in the case of bankers, the demand for mortgage debentures for the purpose of advance has become increasingly frequent.

FRAME WORK OF THE TRUST-DEED

In considering the frame of the trust-deed, the point to be remembered is that the debenture trust-deed with a mortgage or charge usually gives a legal mortgage on specific assets, generally immovable, *i.e.*, those forming what is known as block capital, and also contains a floating charge on the general undertaking of the company, including its stock-in-trade, book debts, uncalled capital or calls made and not yet paid, etc. The usual circumstances under which the mortgage or charge is made enforceable are :—

(1) Arrear or default in the payment of interest or capital;

(2) Winding up;

(3) Breach of any of the covenants;

(4) Those arising out of circumstances under which a receiver has been appointed either by trustees or by other creditors.

These deeds now-a-days are drafted on elaborate lines containing detailed clauses, specimen of which have been dealt with in Vol. II. Besides properties, leases and licenses for the purpose of mortgage, clauses are inserted reiterating that the trustee shall permit the company to hold and enjoy the premises mortgaged and to carry on their business according to the terms and conditions of the deed. The debenture being a first charge is emphasised and the

conditions under which the security is to be enforced are mentioned in these documents in detail. These details contain additional circumstances under which these securities can be enforced, such as levying of tax, or execution upon any part of the premises mortgaged, ceasing to carry on business or threatening to do so, or the company's liabilities exceeding its assets including uncalled capital, or when an alteration in the provision of the memorandum and articles of association is being made, which in the opinion of the trustees is likely to detrimentally affect the interests of the debenture-holders, or where the company creates a mortgage or further charge on the assets of the company so mortgaged without obtaining consent in writing of the trustees, ranking *pari passu* with or in pariority to the security constituted by the trust-deed. In case of enforcing of securities, the clauses in these deeds state in details as to what is to be done with the proceeds of the property. A special clause lays down the powers of the trustees in detail, such as to employ agents, experts, managers, clerks, accountants, servants, workmen and others with salaries and remuneration as the trustees may think fit, to renew machinery which may be worn out or lost or otherwise became unserviceable, or to repair and keep them in working order, insure all or any of the properties mortgaged which are of an insurable nature for any such sums as they think fit, to settle, arrange, compromise and submit to arbitration any accounts, claims, questions or disputes whatsoever, which may arise in connection with said business or the mortgaged premises or in any way affect the securities. To bring, take, defend and compromise, submit to arbitration, discontinue actions and suits or proceedings, civil or criminal, in relation to the business or any portion of the mortgaged property. To allow time for the payment of any debts either with or without security. To execute and do all such acts, deeds and things as they may think necessary and proper for and in relation to such properties and mortgages. To demise the mortgaged premises or any part of them with

such terms and at such rents and in such manner as the trustees think fit, etc.

A further power gives them the right to borrow on the mortgaged property in priority to debenture-holders at the rate of interest they think best.

There are, besides these, the powers to appoint receivers specially reserved in these trust-deeds in connection with the mortgaged premises, or any part of them, or to remove these receivers at their pleasure and to appoint another. These powers are generally given with a view to be exercised after the security has become enforceable for one reason or other including those of fixing the remuneration of the receiver and directing him as to what to do with the money received from the mortgaged premises. The trustees here are also given the right to demand security from the receivers for due performance of their duties and it is finally laid down in this connection that the trustees shall not be responsible for any misconduct or negligence on the part of the receiver.

A special clause specially mentions that the receiver shall be the agent of the company and the company shall be responsible for such receiver's acts, and defaults and for his remuneration, thereby removing this responsibility from the shoulders of the trustees or the debenture-holders.

Specific clauses are also laid down stating how specifically mortgaged premises have to be dealt with at any time before the security becomes enforceable, at the request and at the expense of the company in case in the opinion of the trustees the interests of debenture-holders are not prejudiced thereby. This dealing may be in connection with the selling or converting of this property, letting it on lease, exchanging same for other specific premises, renewing leases, allowing companies or their nominees to exercise powers or rights incidental to ownership, etc.

A special clause is also inserted laying down the duties and obligations of the company toward the debenture-holders in connection with preservation, etc., of their security, such as to carry on their business effectually,

keep accounts and permit accounts to be inspected by the trustees or their nominees, to give information as may be required from time to time by the trustees, to keep the mortgaged assets and the premises in proper care, to permit the trustees to view same whenever they desire, to keep the mortgaged premises insured at the valuation fixed and to produce the receipt of the insurance premium for inspection of the trustees within seven days of same becoming due, to pay all rents that may be due and other taxes and rates regularly, to register the trust-deeds as required by Secs. 109, 109A, 110 and 111 of the Indian Companies Act, 1913, not to pay any dividend while the money due as interest on debentures is not paid, etc. A specific clause relieves the trustees as well as the receivers appointed by them from liability for any loss that may occur to the mortgaged premises, through their entering into possession of same. One other special clause reserves to the trustees the right on their security becoming enforceable, to apply to the Court for any order or direction for the appointment of receiver or receivers, if they so desire the same to be done through the Court. One other special clause states what remuneration if any is to be paid to the trustees. Here it should be borne in mind that unless the remuneration is mentioned they are not entitled to same or where a simple mention of remuneration is made without giving them priority in connection with payment of same, they would rank after the debenture or debenture stockholders (*Hodgson* v. *Accles,* (1902) *W. N.* 164; 51 *W. R.* 57). Frequently, the deed provides for a priority in this connection and gives the trustees a lien which is effective (*Re. Piccadilly Hotel Ltd.,* (1911) 2 *Ch.* 534). Usually, the rule is that on appointment of a receiver the trustees' work is terminated and thus they would not be entitled to remuneration thereafter, but much will depend upon the construction of the clause providing for remuneration (*Re. Locke & Smith Limited,* (1914) 1 *Ch.* 687; *Anglo-Canadian Lands,* (1918) 2 *Ch.* 287; *in re. British Consolidated Oil Corporation,* (1919) 2 *Ch.* 81).

Besides this, special provisions in favour of the trustees to protect them in addition to the powers conferred on them by law, are frequently specified in trust-deeds, to the effect that if the trustee acts on the advice of experts such as lawyers, valuers, accountants, brokers, engineers, etc., they will not be responsible for any loss occasioned for so acting. They shall not be liable for any loss caused through an error in cablegram or while acting on unauthentic message. They would be entitled to accept as sufficient evidence a certificate signed by the chairman of the company and two directors, to the effect that any particular dealing or transaction or step or thing is in the opinion of the person so certifying expedient. That in connection with all the powers given to them, they shall have uncontrolled discretion as to their exercise or non-exercise and that in absence of fraud they shall be in no way responsible for any loss, costs, damages or inconvenience that may result from the exercise or non-exercise thereof. A further power is usually taken by which the trustee is exempted from liability for anything whatsoever except a breach of trust, knowingly and intentionally committed by him. Trustees are also given the discretion to place all title deeds, and documents in connection with property mortgaged in safe deposit, or in receptacles selected by them, or with any banker, etc., and shall not be liable for any loss incurred in that connection.

A special indemnity clause on the usual footing on which it is usually to be found in the articles of association is also inserted in the trust deeds, exonerating the trustees, their receivers, managers or agents free from all liability except in case of fraud, entitling them to be indemnified out of the mortgaged properties in respect of the liabilities incurred by them for costs, charges and expenses incurred in execution of the trust, or of any powers and authorities or discretion vested in them, including the liabilities and expenses consequent on any mistake or oversight error of judgment, forgetfulness or want of prudence on part of trustees or their nominees or agents.

A schedule is usually attached, giving the rules and regulations which are to apply to the meetings of debenture-holders and the mention of it is made in a special case under the debenture trust-deed.

There is also a clause inserted authorising the trustees to delegate any of the powers to any one they appoint and also the power of appointing a company as trustee to act on behalf of them. It is also usually provided that the majority of trustees may act or that two of them or any one of them may act.

The company on its part lays down the time at and terms on which interest and capital are to be paid. A clause is also inserted by which the company agrees to keep a regular debenture register and one other clause deals with the appointment of new trustees and the circumstances under which they are to be so appointed. On the same footing clauses are to be found in the trust-deed providing for the retirement of trustees on giving the requisite notice as provided for in the clause. One of the last clauses provides for re-conveyance of the property to the company on reasonable satisfaction of the debts, charges and expenses.

The above is thus a framework or summary of what a debenture trust deed does usually contain.

General Observations on Debenture Trust-Deeds

In connection with trust-deed, the framework of which we considered above, it must have been observed that the trustees take very little responsibility on themselves. This is perhaps necessary according to the practical needs of the time where attention to details in a sustained manner becomes impossible by the class of people who are generally appointed in that capacity, particularly in these busy days with several engagements of public, private and professional character.

Frequently, special trust companies as in England are appointed as trustees where the chances are that a succession of dealings by way of sale, investments, leasing,

etc., have to be carried out and continuous and immediate attention is thought necessary.

When private individuals are appointed trustees, frequently a director is also appointed as trustee along with others. In connection with this appointment there is considerable difference of opinion and the balance of view happens to be in favour of the argument that such an appointment should be avoided as far as possible, for the simple reason that a director trustee's interest may conflict with his duty. The board of directors here may have for example decided upon a course of action in which the trustee director concurred, but that course of action may not be, in the opinion of his brother trustees in the interest of creditors or debenture-holders and thus a conflict may ensue. The other point to be noted is that where a second mortgage is given to a second series of debenture-holders, the appointment of the same persons who acted as trustees for the first mortgage is undoubtedly undesirable and should be avoided.

Frequently, the trust-deed contains a stipulation by which power is given to the company with the sanction of a meeting of debenture-holders to remove a trustee. In other cases where there is no such power given by the trust-deed, the Court may be moved under the Indian Trustees Act. If, however, the company and all the debenture-holders concur, they can call upon a trustee to retire, but a majority will not have this power in absence of a clause in the trust-deed to that effect and the Court will not compel the trustee to retire on the simple ground that the majority of the debenture-holders wish him to do so (*Assets Realisation Co.* v. *Trustees Executors & Securities Corporation*, 44 *W. R.* 126).

LAW APPLYING TO DEBENTURE TRUST-DEEDS

We have already seen that the object of our debenture trust is to get the mortgage or charge on property transferred to the name of the trustees on behalf of debenture-holders. These trustees in whose names shares of com-

panies are thus transferred under this deed can exercise the voting power in connection with those shares themselves irrespective of whether any interest on debenture loan is in arrear or not (*Siemens Bros. & Co.* v. *Burns*, (1918) 2 *Ch.* 324). The debenture trustees being trustees, all incidents of Trustees Act apply to them including the principles of trustees buying the trust property themselves (*Magadi Soda Co.*, (1925) 94 *L. J. Ch.* 217). The lawyer who acts for trustees has a lien on the trust-deed and other documents in his possession for his cost, both before and after the execution of the trust-deed (*In re. Dee Estates Ltd.*, (1911) 2 *Ch.* 85). Of course, if there is an agreement to the effect that the company or any other party is to pay his cost, the position would be different (*In re. Mason & Taylor*, (1878) 10 *Ch. D.* 729). The debenture certificates when issued along with the trust-deed, generally make a reference to the trust-deed and contain a few important provisions and rules which are to be found in the said deed. Frequently, debentures are redeemed by drawings, *i.e.*, it is arranged in the trust-deed that a certain number of debentures would be paid out every year from a certain reserve fund created out of the profits and that the number of debentures which should be paid out in any particular year is to be ascertained by drawing the numbers by lot. These periodical drawings are not within the Lotteries Act of England (*Wallingford* v. *Mutual Society*, (1880) 5 *A. C.* 685). If the fixed date expires, they will be considered to be due even though no ballot has been held (*In re. Tewkesbury Gas Co.*, (1911) 2 *Ch.* 279, *affirmed*, (1912) 1 *Ch.* 1 *C. A.*).

Redemption of Debentures

Frequently, a debenture trust-deed provides for redemption of debentures by a sinking fund. The idea here is that every year a certain amount is transferred from the company's profits to a special reserve fund known as sinking fund account and after the expiration of the time during which the loan is to run, the debentures are

paid out from this fund which is by that time brought up to the amount of the debenture debt to be redeemed. Here unless it is clearly stated that a sinking fund is intended to be cumulative, *i.e.*, the interest on the redeemed debentures is to be added to the sinking fund, this will not be taken to be the arrangement by mere inference (*Morrison* v. *Chicago & North West Granaries*, (1898) 1 *Ch.* 263). Sometimes the trust-deed provides that the redemption of the debentures is to be effected by a purchase, in which case the trustees may act in the best interest of all concerned (*National Trust Co.* v. *Wicher*, (1912) *A. C.* 377). The debenture deed also sometimes contains a power to the trustees to settle disputed questions in which case they can exercise their discretion (*Noakes* v. *Noakes & Co.*, (1907) 1 *Ch.* 64). If a debenture deed contains a covenant, as it usually does, to the effect that on breach of a covenant, the debt may fall immediately due that will not mean trivial breach or default (*Melbourne Brewery Co.*, (1901) 1 *Ch.* 453). The defendants in one case, issued in 1884 First Mortgage Gold Bonds becoming due in 1934 which were secured by a Mortgaged Trust Deed. The Bonds stated that the defendants promised on due date "to pay to the bearer or to registered-holders thereof £100 sterling gold coin of Great Britain of the present standard of weight and fineness at its agency in London with interest thereon" at 5 per cent. per annum. The plaintiffs claimed in respect of each bond a sum in sterling representing on due date in 1934 the gold value of £100. The Court held that the plaintiffs were not entitled to be paid on such gold basis but only £100 sterling upon the true construction of the bond (*British & French Trust Corporation* v. *The New Brunswick Rly. Co.*, (1936) 1 *K. B.* 13).

Frequently it happens that the trustees get compensation in money when the lease of a property which has been mortgaged with them is not renewed. In this case the rule is that if the trustees have the power of sale before the security becomes enforceable, they may treat it as money arising out of sale (*Noakes* v. *Noakes & Co.*,

(1907) 1 *Ch.* 64; *Bentley's Yorkshire Breweries,* (1909) 2 *Ch.* 609). If on the other hand, the trustees had no such power to deal with the mortgaged assets, the money must be kept invested by them and the company must receive the income (*Law Guarantee Society* v. *Mitcham Brewery,* (1906) 2 *Ch.* 98).

Under the covenants in the trust deed, powers are also given by which the discretion of the trustees is unfettered to consent to any transaction which in their opinion will not prejudice the debenture-holders (*Hamer* v. *London, City & Midland Bank,* (1918) 87 *L. J. K. B.* 973).

The general rule applying to all trustees happens to be that they should not delegate their office either wholly or in part to one of themselves or to a stranger, unless and until the trust-deed expressly or impliedly authorises delegation or where circumstances have a reason under which a prudent man acting for himself would delegate in the ordinary course of business (*Speight* v. *Gaunt,* (1883-84) 9 *A. C.* 5; *Shepherd* v. *Harris,* (1905) 2 *Ch.* 310; *Gasquoine* v.*Gasquoine* (1894) 1 *Ch.* 470). Where however the trustee is a corporation or a company, its directors can act on its behalf (*Ferguson* v. *Wilson,* (1866) *L. R.* 2 *Ch.* 77). A trustee however may employ brokers to buy or sell stock exchange securities (*Speight* v. *Gaunt,* (1883-84) 9 *A. C.* 5). He may also employ a company trustee who happens to be a broker (*Shepherd* v. *Harris,* (1905) 2 *Ch.* 310). However, the present day trust-deeds generally empower the trustees to employ brokers, bankers, solicitors, accountants, etc., and thus these difficulties do not actually arise in practice. Even if the employment of bankers was not specifically provided for in the trust-deed, the trustees can employ them to hold trust funds, but in doing so they must take care to select a bank of repute and reliability (*Swinfen* v. *Swinfen,* 29 *Beav.* 211); but they should not leave the money with the bankers longer than is necessary (*Cann* v. *Cann,* 51 *L. T.* 770; *Rehden* v. *Wesley,* 29 *Beav.* 230). There is no objection if trustees employing solicitors and accountants where they are necessary irrespective of their

power in the trust-deed. The title deeds must be kept by the trustees and they must not permit same to pass out of their control. Even in case of the receiver, they must give inspection to him but not the custody of it (*Ind Coope & Co., Fisher* v. *Same,* (1909) 26 *T. L. R.* 11 *C. A.*). If the trustees act on their own judgment honestly, they will not be responsible for loss resulting on the ground that they did not consult experts (*Cocks* v. *Chapman,* (1896) 2 *Ch.* 763). They can of course file and defend suits in Courts if so advised by their lawyers and where they find that certain action is absolutely necessary in the interest of the state and the trust deed does not give them the power, they can obtain sanction of the Court by satisfying the Court to that effect (*Re. New,* (1901) 2 *Ch.* 534; *Morgan's Brewery Co.* v. *Crosskill,* (1902) 1 *Ch.* 898). The trustees of course are there to watch the interests of the debenture-holders who are the beneficiaries of the trust and to do everything which is necessary to further their interest and abstain from doing that which might injure those interests. No doubt circumstances do arise when the interest of debenture-holders come in conflict with those of the company, when it is the duty of the trust to protect the debenture-holders' interest.

The trust-deed as we have seen secures to the trustees the power of sale and also a proviso for redemption which is generally added at the end of the deed. This power of redemption should be so drafted that the company can redeem only before a default is made in payment of the principal moneys (*Sampson* v. *Pattison* (1842) 1 *Hare* 533). This power of sale, or even the statutory power of sale in case of freehold land mortgaged for a term of years, or on which a charge is given before a legal mortgage may be exercised and when it is exercised the conveyance will vest in the purchaser of the property, subject of course to legal mortgages which carry priority to the mortgage made under the debenture trust-deed, but of course he will be free as to the claims of all mortgages subsequent to the mortgage

given to the debenture-holders. With reference to the appointment of a receiver generally this power is provided for with an express condition that it is to be exercised in the case of great urgency or when the company has gone into winding up. The usual practice is that in case of urgency the trustees when they enter give a certificate of urgency to the company, which may of course be disputed, but the general tendency of the Courts is not to go behind such a certificate if the same is given in their opinion honestly and without being reckless (*Joplin Brewery* v. *Law Guaranteed Trust & Accident Society, Times Newspaper, Nov.* 17, 1909).

The following are the Acts and Sections applying to trustees as to their rights, responsibilities, etc.:—

Appointment of New Trustees

On this question Sec. 35 of the Trustees Act, 1866 lays down as follows: —

"In all cases in which it shall be expedient to appoint a new trustee or new trustees, and it shall be found inexpedient, difficult, or impracticable so as to do without the assistance of the High Court, it shall be lawful for the said Court to make an order appointing a new trustee or new trustees, whether there be any existing trustee or trustees or not at the time of making such order, and, if there be such trustee or trustees, either in substitution for, or in addition to him or them."

Vesting of Trust Property in new or continuing Trustees

On this question Sec. 36 of Trustees Act, 1866 lays down as under: —

"It shall be lawful for the High Court, upon making any order for appointing a new trustee or new trustees, either by the same or buy any subsequent order, to direct that any immoveable property subject to the trust shall vest in the person or persons who, upon the appointment, shall be the trustee or trustees, for such estate as the Court shall direct.

Such order shall have the same effect as if the person or persons, who, before such order, was or were the trustee or trustees

(if any) had duly executed all proper conveyances of such property for such estate."

Sec. 75 of Trusts Act, 1882 lays down as follows :—

"Whenever any new trustee is appointed under Sec. 73 or Sec. 74, all the trust-property for the time being vested in the surviving or continuing trustees or trustee, or in the legal representative of any trustee, shall become vested in such new trustee, either solely, or jointly with the surviving or continuing trustees or trustee, as the case may require."

Old Trustees not Discharged from Liability

On this question Sec. 36 of Trustees Act 1866 lays down as under:—

"Any such appointment by the High Court of new trustees, and any such conveyance or transfer as aforesaid, shall operate no further or otherwise as a discharge to any former for continuing trustee, than an appointment of new trustees under any power for that purpose contained in any instrument would have done."

Sec. 34 of the Trustees and Mortgagees' Powers Act, 1866 lays down as follows: —

"Whenever any trustee, either original or substituted, and whether appointed by any High Court or otherwise, shall die, or be six months absent from British India, or desire to be discharged from, or refuse, or become unfit or incapable, to act in the trusts or powers in him reposed, before the same shall have been fully discharged and performed, it shall be lawful for the person or persons, nominated for that purpose, by the deed, will or other instrument creating the trust (if any), or if there be no such person or no such person able and willing to act, then for the surviving or continuing trustees or trustee for the time being, or the acting executors or executor, or administrators or administrator of the last surviving and continuing trustee, or for the retiring trustees, if they shall all retire simultaneously, or for the last retiring trustee, or where there are two or more classes of trustees of the instrument creating the trust, then for the surviving or continuing trustees or trustee of the class in which any such vacancy or disqualification shall occur (and for this purpose any refusing or retiring trustee shall, if willing to act in the execution of the power, be considered a continuing trustee), by writing to appoint any other person or persons to be a trustee or trustees in the place of the trustee or trustees so dying, or being absent from

British India, or desiring to be discharged, or refusing or becoming unfit or incapable to act as aforesaid."

Secs. 73 & 74 of the Trusts Act of 1882 lay down as under:—

"Whenever any person appointed a trustee disclaims, or any trustee, either original or substituted, dies, or is, for a continuous period of six months, absent from British India or leaves British India for the purpose of residing abroad, or is declared an insolvent, or desires to be discharged from the trust, or refuses or becomes, in the opinion of a principal Civil Court of original jurisdiction, unfit or personally incapable to act in the trust, or accepts an inconsistent trust, a new trustee may be appointed in his place by :—

(*a*) the person nominated for that purpose by the instrument of trust (if any), or

(*b*) if there be no such person, or no such person able and willing to act, the author of the trust, if he be alive and competent to contract, or the survivor continuing trustees or trustee for the time being, or legal representative of the last surviving and continuing trustee, or (with the consent of the Court) the retiring trustees, if they all retire simultaneously, or (with the like consent) the last retiring trustee.

Every such appointment shall be by writing under the hand of the person making it.

On an appointment of a new trustee, the number of trustees may be increased.

The official trustee may, with the consent, and by the order of the Court, be appointed under this section, in any case in which only one trustee is to be appointed, and such trustee is to be the sole trustee. The provisions of this section relative to a trustee who is dead include the case of a person nominated trustee in a will, but dying before the testator, and those relative to a continuing trustee include a refusing or retiring trustee if willing to act in the execution of the power."

"Whenever any such vacancy or disqualification occurs, and it is found impracticable to appoint a new trustee under Sec. 73, the beneficiary may, without instituting a suit, apply by petition to a principal Civil Court of original jurisdiction, for the appointment of a trustee or a new trustee, and the Court may appoint a trustee or a new trustee accordingly."

Retirement of Trustees

On the above question Sec. 72 of Trusts Act, 1882 lays down as under:—

"Notwithstanding the provisions of Sec. 11, every trustee may apply by petition to a principal Civil Court of original jurisdiction to be discharged from his office; and if the Court finds that there is sufficient reason for such discharge, it may discharge him accordingly, and direct his costs to be paid out of the trust-property. But, where there is no such reason, the Court shall not discharge him, unless a proper person can be found to take his place."

Vacating the Office of Trustees

In this connection Secs. 70 and 71 of the Trusts Act, 1882 lay down as under:—

"The office of a trustee is vacated by his death or by his discharge from his office."

"A trustee may be discharged from his office only as follows—

(*a*) by the extinction of the trust;
(*b*) by the completion of his duties under the trust;
(*c*) by such means as may be prescribed by the instrument of trust;
(*d*) by appointment under this act of a new trustee in his place;
(*e*) by consent of himself and the beneficiary, or, where there are more beneficiaries, than one, all the beneficiaries being competent to contract, or
(*f*) by the Court to which a petition for his discharge is presented under this act."

Advice of Court re. Management

On the above question Sec. 43 of Trustees and Mortgagees Powers Act, 1866 lays down as follows :—

"Any trustee, executor, or administrator shall be at liberty without the institution of a suit, to apply by petition to any Judge of the High Court for the opinion, advice, or direction of such Judge on any question respecting the management or administration of the trust property or the assets of any testator or intestate.

Such application shall be served upon, or the hearing thereof shall be attended by all persons interested in such application, or such of them as the said Judge shall think expedient.

The trustee, executor, or administrator acting upon the opinion, advice, or direction given by the said Judge, shall be deemed, so far as regards his own responsibility, to have discharged

his duty as such trustee, executor, or administrator in the subject-matter of the said application;

Provided, nevertheless, that this Act shall not extend to indemnify any trustee, executor, or administrator, in respect of any act done in accordance with such opinion, advice or direction as aforesaid, if such trustee, executor or administrator shall have been guilty of any fraud or wilful concealment or misrepresentation in obtaining such opinion, advice or direction; and the costs of such application as aforesaid shall be in the discretion of the Judge to whom the said application shall be made."

Powers of Trustees for Sale by Auction etc.

On the above question Secs. 2, 3 and 4 of Trustees and Mortgagees' Powers Act, 1866 lay down as follows :—

"In all cases where, by any will, deed, or other instrument of settlement, it is expressly declared that trustees or other persons therein named or indicated shall have a power of sale, either generally or in any particular event, over any immoveable property named or referred to in, or from time to time subject to, the uses or trusts of such will, deed, or other instrument, it shall be lawful for such trustees or other persons, whether such property be vested in them or not, to exercise such power of sale by selling such property either together or in lots, and either by public auction or private contract, and either at one time or at several times."

"It shall be lawful for the persons making any such sale to insert any such special or other stipulations, either as to title or evidence of title, or otherwise, in any conditions of sale, or contract for sale, as they shall think fit, and also to buy in the property or any part thereof at any sale by auction, and to rescind or vary any contract for sale, and to resell the property which shall be so bought in, or as to which the contract shall be so rescinded, without being responsible for any loss which may be occasioned thereby,

and no purchaser under any such sale shall be bound to enquire whether the person making the same may or may not have in contemplation any particular re-investment of the purchase-money in the purchase of any other property or otherwise."

"For the purpose of completing any such sale as aforesaid, the persons empowered to sell as aforesaid shall have full power to convey or otherwise dispose of the property in question in such a manner as may be necessary."

Secs. 37 and 38 of the Trusts Act of 1882 lay down the following :—

"Where the trustee is empowered to sell any trust-property he may sell the same subject to prior charges or not, and either together or in lots, by public auction or private contract, and either at one time or at several times, unless the instrument of trust otherwise directs."

"The trustee making any such sale may insert such reasonable stipulations either as to title or evidence of title, or otherwise, in any conditions of sale or contract for sale, as he thinks fit, and may also buy in the property, or any part thereof, at any sale by auction, and rescind or vary any contract for sale, and resell the property so bought in, or as to which the contract is so rescinded, without being responsible to the beneficiary for any loss occasioned thereby.

Power of Trustees to give Receipt

On this question Sec. 7 of Trustees and Mortgagees' Powers Act, 1866 lays down as follows :—

"Receipts for purchase-money given by the person or persons exercising the power of sale hereby conferred shall be sufficient discharges to the purchasers, who shall not be bound to see to the application of such purchase-money."

Sec. 36 of the Trustees and Mortgagees' Powers Act, 1866 lays down as under:—

"The receipts in writing of any trustees or trustee for any money payable to them or him by reason, or in the exercise, of any trusts or powers reposed or vested in them or him, shall be sufficient discharges for the money therein expressed to be received, and shall effectually exonerate the persons paying such money from seeing to the application thereof, or from being answerable for any loss or misapplication thereof."

Powers of Executors and Trustees to Compound, etc.

On the above question Sec. 38 of Trustees and Mortgagees' Powers Act, 1866 lays down :—

"It shall be lawful for any executors to pay any debts or claims upon any evidence that they may think sufficient, and to accept any composition, or any security for any debts due to the deceased, and to allow any time for payment of any such debts as he shall think fit, and also to compromise, compound, or submit to arbitration all debts, account claims and things whatsoever relating to the estate of the deceased, and for any of the purposes

aforesaid to enter into, give and execute such agreements, instruments of composition, releases, and other things as they shall think expedient, without being responsible for any loss to be occasioned thereby."

Section 43 of Trusts Act, 1882 lays down as under :—

"Two or more trustees acting together may if and as they think fit."—

(a) accept any composition or any security for any debt or for any property claimed;

(b) allow any time for payment aof any debt;

(c) compromise, compound, abandon, submit to arbitration, or otherwise settle any debt, account, claim, or thing whatever relating to the trust; and

(d) for any of those purposes, enter into, give, execute, and do such agreements, instruments of composition or arrangement, releases, and other things as to them seem expedient, without being responsible for any loss occasioned by any act or thing so done by them in good faith.

The powers conferred by this section on two or more trustees acting together may be exercised by a sole acting trustee when, by the instrument of trust (if any), a sole trustee is authorised to execute trusts and powers thereof.

This section applies only if and as far as a contrary intention is not expressed in the instrument of trust (if any) and shall have effect subject to the terms of that instrument and to the provisions therein contained.

This section applies only to trusts created after this Act comes into force.

Implied Indemnity of Trustees

On the above question Sec. 37 of Trustees and Mortgagees' Powers Act, 1866 lays down as under :—

"Every deed, will, or other instrument creating a trust, either expressly or by implication, shall without prejudice to the clauses actually contained therein, be deemed to contain a clause in the words or to the effect following, that is to say, "that the trustees or trustee for the time being of the said deed, will, or other instrument, shall be respectively chargeable only for such moneys, stocks, funds, and securities as they shall respectively actually receive, notwithstanding their respectively signing any receipt for the sake of conformity, and shall be answerable and accountable only for their own acts, receipts, neglects, or defaults,

and not for those of each other nor for any banker, broker, or other person with whom any trust-moneys or securities may be deposited, nor for the insufficiency or deficiency of any stocks, funds or securities, nor for any other loss, unless the same shall happen through their own wilful default respectively; and also that it shall be lawful for the trustees or trustee for the time being of the said deed, will, or other instrument, to reimburse themselves or himself, or pay or discharge out of the trust-premises all expenses incurred in or about the execution of the trusts or powers of the said deed, will or other instrument."

Powers of Mortgagees

On the above question Secs. 6 and 8 of Trustees and Mortgagees' Powers Act, 1866 lay down as fellows :—

"Where any principal-money is secured or charged by deed on any immoveable property, or on any interest therein, the person to whom such money, shall for the time being be payable, his executors, administrators, and assigns shall, at any time after the expiration of one year from the time when such principal-money shall have become payable, according to the terms of the deed, or after any interest on such principal-money shall have been in arrear for six months, or after any omission to pay any premium on any insurance which by the terms of the deed ought to be paid by the person entitled to the property subject to the charge, have the following powers to the same extent (but no more) as if they had been in terms conferred by the person creating the charge, namely :—

1st, a power to sell, or concur with any other person in selling, the whole or any part of the property by public auction or private contract, subject to any reasonable conditions he may think fit to make, and to rescind or vary contracts for sale, or buy in and re-sell the property, for time to time, in like manner;

2nd, a power to appoint or obtain the appointment of a receiver of the rents and profits of the whole or any part of the property in manner hereinafter mentioned."

Application of Purchase-money

On the above question, Sec. 9 of Trustees and Mortgagees' Powers Act, 1866 lays down as follows :—

"The money arising by any sale effected as aforesaid shall be applied by the person receiving the same as follows :

first, in payment of all expenses incident to the sale or incurred in any attempted sale;

secondly, in discharge of all interest and costs then due in respect of the charge in consequence whereof the sale was made; and

thirdly, in discharge of all the principal-moneys then due in respect of such charge;

and the residue of such money shall be paid to the person entitled to the property subject to the charge, his executors, administrators or assigns, as the case may be."

Conveyance to Purchaser

On the above question, Sec. 10 of Trustees and Mortgagees' Powers Act, 1866 lays down as under :—

"The person exercising the power of sale hereby conferred shall have power by deed to convey or assign to and vest in the purchaser the property sold, for all the estate and interest therein which the person who created the charge had power to dispose of;

Provided that nothing herein contained shall be construed to authorize the mortgagee of a term of years to sell and convey the fee simple of the property comprised therein in cases where the mortgagor could have disposed of such fee simple at the date of the mortgage."

Owner of Charge may call for Title-deeds and Conveyance of Legal Estate

On the above question, Sec. 11 of Trustees and Mortgagees' Powers Act, 1866 lays down as follows :—

"At any time after the power of sale hereby conferred shall have become exerciseable, the person entitled to exercise the same shall be entitled to demand and recover from the person entitled to the property subject to the charge, all the deeds and documents in his possession or power relating to the same property, or to the title thereto, which he would have been entitled to demand and recover if the same property had been conveyed, appointed, or surrendered to and were then vested in him for all the estate and interest which the person creating the charge had power to dispose of;

and where the legal estate shall be outstanding in a trustee, the person entitled to a charge created by a person equitably entitled, or any purchaser from such person, shall be entitled, to call for a conveyance of the legal estate to the same extent as the person creating the charge could have called for such a conveyance if the charge had not been made."

Investment of Trust Funds

In this connection Sec. 32 of Trustees and Mortgagees' Powers Act, 1866 and Sec. 20 of Trusts Act, 1882 lay down as under :—

Sec. 32 :—"Trustees having trust-money in their hands, which it is their duty to invest at interest shall be at liberty, at their discretion, to invest the same in any Government securities, and such trustees shall also be at liberty, at their discretion, to call in any trust-funds invested in any other securities than as aforesaid, and to invest the same on any such securities as aforesaid, and also from time to time at their discretion, to vary any such investments as aforesaid for others of the same nature;

Provided always that no such original investment as aforesaid, and no such change of investment as aforesaid, shall be made where there is a person under no disability entitled in possession to receive the income of the trust-fund for his life, or for a term of years determinable with his life. or for any greater estate, without the consent in writing of such person."

Sec. 20 :—Where the trust-property consists of money, and cannot be applied immediately or at an early date to the purposes of the trust, the trustee is bound (subject to any direction contained in the instrument of trust) to invest the money on the following securities, and on no others :—

(*a*) in promissory notes, debentures, stock or other securities "of any local government or" of the Government of India, or of the United Kingdom of Great Britain and Ireland;

"Provided that securities, both the principal whereof and the interest whereon shall have been fully and unconditionally guaranteed by any such Government, shall be deemed, for the purposes of this clause to be securities of such Government."

(*b*) in bonds, debentures and annuities charged by the Imperial Parliament on the revenues of India;

"Provided that after the fifteenth day of February, 1916, no money shall be invested in any such annuity being a terminable annuity unless a sinking fund has been established in connection with such annuity; but nothing in this proviso shall apply to investments made before the date aforesaid."

(*bb*) in India three and a half per cent. stock, India three per cent. stock, India two and half per cent. stock or any other capital stock which may at any time hereafter be issued by the Secretary of State for India in Council, under the authority of an Act of Parliament and charged on the revenues of India;

(*c*) in stock or debentures of, or shares in, Railway or other companies, the interest whereon shall have been guaranteed by the

Secretary of State for India in Council, "or by the Government of India" "or in debentures of the Bombay Provincial Co-operative Bank, Limited, the interest whereon shall have been guaranteed, by the Secretary of State for India in Council."

(*d*) in debentures or other securities for money issued, under the authority of any Act of a legislature established in British India, by or on behalf of any Municipal body, port trust or city improvement trust in any Presidency town or in Rangoon Town, or by or on behalf of the trustees of the port of Karachi;"

(*e*) on a first mortgage of immovable property situate in British India; provided that the property is not a leasehold for a term of years, and that the value of the property exceeds by one-third or, if consisting of buildings, exceeds by one-half, the mortgage-money; or

(*f*) on any other security expressly authorised by the instrument, of trust, or by any rule which the High Court may, from time to time, prescribe in this behalf;

Provided that, where there is a person competent to contract, and entitled in possession to receive the income of the trust-property for his life, or for any greater estate, no investment, on any security mentioned or referred to in clauses (d), (e) and (f) shall be made without his consent in writing.

Trustee to Protect Title to Trust-Property

In this connection Sec. 13 of Trusts Act, 1882 lays down as under :—

"A trustee is bound to maintain and defend all such suits, and (subject to the provisions of the instrument of trust) to take such other steps as, regard being had to the nature and amount or value of the trust-property, may be reasonably requisite for the preservation of the trust-property and the assertion or protection of the title thereto."

Trustee to Inform Himself of State of Trust-Property

On the above question Sec. 12 of Trusts Act, 1882 lays down as under :—

"A trustee is bound to acquaint himself, as soon as possible, with the nature and circumstances of the trust-property to obtain, where necessary, a transfer of the trust-property to himself; and subject to the provisions of the instrument of trust to get in trust-moneys invested on insufficient or hazardous security."

Care Required from Trustee

In this connection, Sec. 15 of Trusts Act, 1882 lays down as under:—

"A trustee is bound to deal with the trust-property as carefully as a man of ordinary prudence would deal with such property if it were his own; and, in the absence of a contract to the contrary, a trustee so dealing is not responsible for the loss, destruction, or deterioration of the trust property."

Non-liability for Co-trustee's Default

In this connection, Sec. 25 of Trusts Act, 1882 lays down as follows:—

"Where a trustee succeeds another he is not, as such, liable for the acts or defaults of his predecessor."

NOTES :—*Vide Re. Chapman*, (1896) 2 *Ch. C. A.* 763.

Non-liability for Predecessor's Default

In this connection, Sec. 26 of Trusts Act, 1882 lays down as under :—

"Subject to the provisions of Sections 13 and 15, one trustee is not, as such, liable for a breach of trust committed by his co-trustee;

Provided that, in the absence of an express declaration to the contrary in the instrument of trust, a trustee is so liable.

(*a*) where he has delivered trust-property to his co-trustee without seeing to its proper application;

(*b*) where he allows his co-trustee to receive trust-property, and fails to make due enquiry as to the co-trustee's dealings therewith, or allows him to retain it longer than the circumstances of the case reasonably require;

(*c*) where he becomes aware of a breach of trust committed or intended by his co-trustee, and either actively conceals it, or does not, within a reasonable time, take proper steps to protect the beneficiary's interest."

Right to Title-deed

In this connection, Sec. 26 of Trusts Act, 1882 lays down as follows :—

"A trustee is entitled to have in his possession the instrument

of trust and all the documents of title (if any) relating solely to the trust-property."

NOTES :—The trustees have a right to the custody of the title deeds for the benefit of all parties interested (*Garner* v. *Honnyngton*, 22 *Beav.* 630; *Stanford* v. *Roberts*, 6 *L. R. Ch. App.* 307).

General authority of Trustees

In this connection, Sec. 31 of Trusts Act, 1882 lays down as follows:—

"In addition to the powers expressly conferred by this Act, and by the instrument of trust, and subject to the restrictions (if any) contained in such instrument, and to the provisions of Section 17, a trustee may do all acts which are reasonable and proper for the realisation, protection, or benefit of the trust-property, and for the protection or support of a beneficiary who is not competent to contract.

Except with the permission of a principal Civil Court of original jurisdiction, no trustee shall lease trust-property for a term exceeding twenty-one years from the date of executing the lease, not without reserving the best yearly rent that can be reasonably obtained."

LIMITATION ACT AND THE TRUSTEES

The general law is that in case of a breach of trust there is no limitation of time which bars the beneficiaries from recovering their estate by statute against the trustees and thus under that law the debenture-holders who are the beneficiaries of the debenture trust-deed can sue their trustees at any period after a breach of trust by them. In this connection Sec. 10 of the Indian Limitation Act of 1908 lays down as follows:—

"Notwithstanding anything hereinbefore contained, no suit against a person in whom property has become vested in trust for any specific purpose, or against his legal representatives or assigns (not being assigns for valuable consideration), for the purpose of following in his or their hands such property, or the proceeds thereof, or for an account of such property or proceeds, shall be barred by any length of time."

The suit in this connection must be brought against the trustees expressly mentioned in the trust deed with a view to follow the property or receipts and accounts

(*Bhurabhai Jamnadas & Others* v. *Bai Ruxmani*, (1908) 32 *Bom.* 394). If, however, a suit is brought against the trustees for damages and not with a view to follow the property, the above Sec. 10 is inapplicable and the suit is liable to be barred by Article 120 of the Limitation Act. The debenture trust-deed is undoubtedly an express trust in every sense of the term because there the property is vested in the trustees who are expressly mentioned in the document (*Barkat* v. *Daulat & Others*, (1882) 4 *All.* 187; *Bhurabhai Jamnadas & Others* v. *Bai Ruxmani*, (1908) 32 *Bom.* 394). The expression "express trust" is equivalent to our Indian expression "trust for specific purpose" (*Mathuradas Damodardas & Others* v. *Vandravandas Sunderji & Others*, (1907) 31 *Bom.* 222; *Vundravandas Purshottamdas* v. *Cursondas Govindji*, (1897) 21 *Bom.* 646) and even when the suit against the trustee is not merely on account of following the trust-property but for account Sec. 10 will apply.

In case where the trustee is dead and a suit is to be brought against his representative "to recover trust-property," the said suit is exempt from limitation. If, however, this suit is not for "claiming specific property," the same must be brought within three years under Article 98 of Limitation Act. Though the trustee cannot plead an adverse title against his own *cesti qui* trust, it should be noted that if the adverse position is taken by a stranger to the trust by enforcing upon the trust-property, the same may be pleaded adversely against the *cesti qui* trust and the trustee, the fact that the trust exists would not prevent the statute running in his favour (*East Stonehouse Urban District Council* v. *Willoughby Brothers Ltd.*, (1902) 2 *K. B.* 318). If, however, the *cesti qui* trust is under disability such as an infant, it is thought that his rights may be saved under Sec. 6 of the Indian Limitation Act. When a trustee sues his co-trustee to reimburse the money lost to the trust by the other trustee's breach of trust, Sec. 10 will not apply for the simple reason that here the object is not to fix

a suit to recover for the trust property which belong to him and second reason is that the suit is not by a beneficiary (*Ranga Pai and another* v. *Baba and another,* (1897) 20 *Mad.* 398). In such cases the residuary Article 120 applies as decided in the same case. According to Sec. 10 an assignee for value is exempt from its operation which means that he is a *bona fide* purchaser of the property for value innocently, but a donee or legatee of a trust will not be exempted even if he takes without notice. Suits against these assignees for value such as purchasers, mortgagees, lessees etc., are liable to be barred by one of the Articles in the schedule of the Indian Limitation Act (*Manavikraman Ettan Thamburan* v. *Ammu and others,* (1901) 24 *Mad.* 471 (*F. B.*). All such cases would be covered by Article 134 as amended by the Act of 1908. In case of moveable properties in such cases Article 133 of the Indian Limitation Act would apply.

RECEIVER ON BEHALF OF DEBENTURE-HOLDERS

We have seen above that frequently a debenture trust-deed gives power to trustees to appoint receivers and that in case there is no such power, a receiver may be appointed by an application to the Court. This power to appoint receiver by the Court at the instance of a debenture-holder, mortgagee or trustee on behalf of debenture-holders includes a power to appoint a manager for the protection of the property or security where any business is included in the mortgage or charge. Even though the debenture-holders have the power through their trustee, the Court can interfere and appoint its own receiver in place of or instead of one appointed by the debenture-holders, if that is necessary in the interest of justice as *e.g.*, for the protection of minority (*Hoare* v. *Slogger Automatic Co.,* (1915) 1 *Ch.* 478).

The circumstances under which the debenture-holders can apply for appointment of a receiver are where there is a danger of the property being lost or diminished in

value or where the principal or interest is in arrear or even where though there is no such arrear, the assets are in danger (*McMahon* v. *North Kent Iron Works Co.*, (1891) 2 *Ch.* 148; *Thorn* v. *Nine Reefs*, (1892) 67 *L. T.* 93; *Braunstein & Marjolaine*, (1914) *W. N.* 335). Or where the company is in liquidation and is on the point of being wound up (*Victoria Steam Boats Co.*, (1897) 1 *Ch.* 158; *Wallace* v. *Universal Co.*, (1894) 2 *Ch.* 547) or where there are decrees and judgments against the company (*Edwards* v. *Standard Rolling Stock Syndicate*, (1893) 1 *Ch.* 574) or where the company is in a state of suspended animation (*Higginson* v. *German Athenaeum*, (1916) 32 *T. L. R.* 277) or as in one case a receiver was appointed where the company wanted to distribute its only assets which constituted its reserve fund among its members (*Re. Tilt Cove Copper Co.*, (1913) 2 *Ch.* 588). They can also apply when circumstances have arisen which would make a sale necessary in the near future (*Smith* v. *Wilkinson*, (1897) 1 *Ch.* 158). It has been held that a power to get in the property includes power to bring action for the purpose in the name of the company (*M. Wheeler & Co. Ltd.* v. *Warren*, (1928) *Ch.* 840).

The general debenture trust-deeds contain a clause expressly providing that the receiver shall be the agent of a company, because in absence of that he may be held to be the agent of debenture-holders, whereby exposing them to liability (*Bissell* v. *Ariel Motors*, (1910) 27 *T. L. R.* 73; *Cully* v. *Parsons*, (1923) 2 *Ch.* 512). It has been held that if the appointment of a receiver and manager is of a permanent character, it would operate as a discharge of the company's servants, unless the appointment is by the debenture-holders and it is expressly stated in the deed that the receiver is an agent of the company (*Reid* v. *Explosives Co.*, (1887) 56 *L. J. Q. B.* 388). A receiver or receiver and manager may also be appointed in proceedings which have commenced with originating summons (*Re. Francke*, (1888) 57 *L. J. Ch.* 437; *Gee* v. *Bell*, (1887) 35 *Ch. D.* 160). A receiver or manager may be appointed

from the directors in a debenture-holders' action and notwithstanding that he is entitled to be paid his fees as director (*Re. South Western of Venezuela Rail Co.*, (1902) 1 *Ch.* 701). It has been held that where there are cases where the debenture-holders' security is in "jeopardy," the Courts may appoint receivers if such cases are likely to work against interest of debenture-holders or are likely to destroy their security (*London Pressed Hinge Co.*, (1905) 1 *Ch.* 576). If one part of the estates is in jeopardy and others are not, a receiver and manager of that part only may be appointed (*Grigson* v. *George Taplin & Co.*, (1915) 112 *L. T.* 985). These receivers have been appointed when the company's business was practically at an end and the reserve fund created out of its profits was the only asset left or where the company was on the point of shutting up its business and letting its property (*Tilt Cove Copper Co. Re.*, (1913) 2 *Ch.* 588; *Braunstein & Marjolaine*, (1914) *W. N.* 335). The fact that the debenture-holders have appointed a receiver in powers reserved to them by their debenture does not prevent the Court appointing its own receiver (*Re. Slogger Automatic Co.*, (1915) 1 *Ch.* 478).

Registration of appointment of Receiver and Accounts

When the receiver of the company's property is appointed either by the Court or by debenture-holders, Sec. 118 of the Indian Companies Act lays down that the notice of the fact must be filed with the registrar within 15 days from the date of the order or of the appointment under the powers contained in the instrument, failing which, every person making default in complying with the requirements of this section is liable to a fine not exceeding Rs. 50 for every day during which the default continues. When the receiver is appointed by the Court, he is usually required under the order appointing him to pass his accounts in the same manner as every other receiver. In case of a receiver appointed under powers contained in any instrument who has taken possession, he is required by Sec. 119 of the Indian Companies Act, 1913 to once in every half year,

while the remains in possession and also on ceasing to act as receiver, file with the registrar an abstract in the prescribed form of his receipts and payments during the period to which the abstract relates and shall also on ceasing to act as receiver file with the registrar notice to that effect and the registrar shall enter the notice in the register of mortgages and charges. *The other requirement is that every invoice, order for goods, or business letter issued by or on behalf of the company, or the receiver of the company, being a document on or in which the name of the company appears shall contain a statement that a receiver has been appointed. The company and every director, manager, managing agent, secretary or other officer of the company and every receiver knowingly and wilfully permitting the default shall be liable to a fine not exceeding two hundred rupees.* The form of notice of appointment is Form 13 under the Indian Companies Rules 1914 of the Bombay High Court and the Form of Accounts is the Form No. 14 and the Form of Notice to be given by such receiver on ceasing to act as such is Form No. 15.

Manager

The general practice is that the Court only appoints a manager on the understanding that it will be for a temporary period and for an immediate sale. A manager is only appointed where the charge covers the business of the company (*Makins* v. *Percy Ibbotson & Co.*, (1891) 1 *Ch.* 133; *Salter* v. *Leas Hotel Co.*, (1902) 1 *Ch.* 332). Frequently, a time is fixed by the Court in this connection and if he exceeds that, he will not be allowed any remuneration during the excess period (*Trenchard* v. *Wood-Green Steam Laundry*, (1918) 1 *Ch.* 423). There are concerns such as railway, tramway or water companies, of a public undertaking character, where sale cannot be ordered, in which case a manager will not be appointed (*Blaker* v. *Herts & Essex Waterworks*, (1889) 41 *Ch. D.* 406; *Marshall* v. *South Staffordshire Tramways Co.*, (1895) 2 *Ch.* 36).

When the receiver and manager incurs expenses properly

for carrying on the business, they are entitled to recoup themselves from the estates in priority to those parties for whose benefit they acted and the remuneration also would take precedence over the cause of action of the party who got them appointed (*Strapp* v. *Bull & Sons,* (1895) 2 *Ch.* 1; *Glasdir Copper Mines,* (1906) 1 *Ch.* 365). Whether the receiver and manager is to be allowed to take or continue proceedings at the cost of the company's assets, it is for the Court to decide (*Viola* v. *Anglo-American Cold Storage Co.,* (1912) 2 *Ch.* 305). Where they are appointed by debenture-holders and not declared to be the agent of the company, receiver may sue the debenture-holders for his remuneration (*Deyes* v. *Wood & others,* (1911) 1 *K. B.* 806). In one case the receiver and manager was not allowed his remuneration and part of his expenses when he continued to manage after the expiry of the period limited (*Re. Wood-Green Laundry,* (1918) 1 *Ch.* 423).

The Powers and Legal Authority of Receivers

Though as a general practice in law, the receiver cannot make or enforce calls, in case the company is in liquidation, because the liquidator is the only authority who can do so and when an adequate indemnity is given, the receiver of the mortgage of the uncalled capital may obtain leave to use the liquidator's name in proceedings to enforce calls (*Fowler* v. *Broad's Patent Night Light Co.,* (1893) 1 *Ch.* 724; *Harrison* v. *St. Etienne Brewery Co.,* (1893) 37 *Sol. J.* 562). When a receiver is appointed by the Court, he naturally becomes an officer of the Court and interference with him constitutes a contempt of the Court (*Anes* v. *Birkenhead Docks Trustees,* (1855) 20 *Beav.* 338; *Russell* v. *East Anglian Rail Co.,* (1850) 3 *Mac. & G.* 104). It is the duty of the receiver to collect and get in the property which forms the subject-matter of his security, except the uncalled capital. When a receiver has entered into a contract he may by the term in the contract exclude personal liability (*Re. Hawkins (Earnest) & Co.,* (1915) 31 *T. L. R.* 247). When a company is being

wound up and an application is made on behalf of debenture-holders for the appointment of a receiver, the usual tendency of the Court is to appoint the liquidator as the receiver, except of course where if there are exceptional circumstances, such as the hostility having been shown by the liquidator to the debenture-holders (*Gibs* v. *Nuthell, In re. House Improvement Supply Association,* (1885) *W. N.* 51). Also where there is a large amount of unpaid capital, the liquidator may be appointed a receiver to collect same, otherwise the Court will not force him on the debenture-holders (*Bartlett* v. *Northumberland Avenue Hotel*, (1885) 53 *L. T.* 611; *Barney* v. *Joshua Stubbs, Ltd.*, (1891) 1 *Ch.* 475).

The duties of the receiver will largely depend on the circumstances of the order and the character of the property of which he is appointed the receiver. On the same principle a trustee for debenture-holders is bound to protect the property and preserve same for the debenture-holders. In case of immoveable properties, he must take possession of them and give notice to the tenants and endeavour to see that he procures them to attorn. In case of moveable properties also he should take possession of them immediately. In case of assets, such as book debts, bank deposits etc., he should take immediate steps by giving proper notices to collect them or bring them under his control. The receiver is also a manager whose duty is to conduct business on the same footing as a man of ordinary prudence. Where a tenant of immoveable property refuses to attorn to him, he can make an application to the Court to get him to do so (*Reid* v. *Middleton,* 1 *R. & R.* 455). A receiver who has been appointed on the condition that he should give security, cannot take possession unless he has done so (*Edwards* v. *Edwards,* (1876) 2 *Ch. D.* 291). A receiver who is appointed by Court is not an agent of anybody and though he is an officer of the Court, he is a principal (*Burt* v. *Bull,* (1895) 1 *Q. B.* 276; *Glasdir Copper Mines,* (1906) 1 *Ch.* 365; *Garner* v. *L. C. & D. Rail Co.,* (1867) 2 *Ch.* 201). A receiver of course cannot without

special leave purchase the property of which he is a receiver (*Nugent* v. *Nugent,* (1908) 1 *Ch.* 546). The Court which appoints a receiver can prevent his being made a subject of action in another Court with regard to its conduct by an injunction, restraining any one from commencing such action (*In re. Maidstone Palace of Varieties,* (1909) 2 *Ch.* 283). A receiver is not liable for rent in respect of company's leasehold property, neither does the payment of said rent on company's behalf by him make him tenant by estoppel (*Hay* v. *Swedish and Norwegian Rail Co.,* (1889) 5 *T. L. R.* 460; *Justice* v. *James,* (1899) 15 *T. L. R.* 181). Where a debenture trustee holds lands by mortgage by a subdemise, the landlord is not entitled to be paid his rent out of the proceeds of goods on the land in the hands of the receiver (*Hand* v. *Blow,* (1901) 2 *Ch.* 721).

The trade contracts do not come to an end through the appointment of a receiver by the Court, though the receiver has the power through the sanction of the Court to refuse to carry them out when the other parties shall have only action in damages (*Parsons* v. *Sovereign Bank of Canada,* (1913) *A. C.* 160). The principle is that the Court will not sanction wholesale repudiation of contracts unless it is shown that there is no possibility of the general creditor receiving anything (*Newdigate Colliery Co.,* (1912) 1 *Ch.* 468). The breaking of contracts should not destroy the good-will, as in that case the Court will not allow same to be done according to the same authority. There have been cases where the Court has authorised the receiver to borrow and charge the repayment in priority to the debenture-holders and a similar power is allowed to be exercised by re-borrowing after the original loan was paid off (*Greenwood* v. *Algeciras Ry.,* (1894) 2 *Ch.* 205; *Milward* v. *Avill,* (1897) 4 *Mans.* 403 *or* (1897) *W. N.* 162; *Lathom* v. *Greenwich Ferry Co.,* (1895) *W. N.* 77). A receiver who retains good-will of the business cannot disregard forward contracts of the company if they have become unprofitable (*Newdigate Colliery Co.,* (1912) 1 *Ch.* 468). A receiver is also not permitted by the Court to borrow in

order to complete a contract where no direct profit can result from such completion (*Thames Iron-works Co.,* (1912) 28 *T. L. R.* 273).

We have seen that in case of debenture-holders, the trust-deed will itself lay down how far the trustees have the power to appoint receivers. If there is an express power to appoint receivers, then they have also been generally provided for in the same trust-deed within what sphere the receiver should act. If the power to appoint a receiver is vested in only one of the many debenture-holders, he should exercise that power as a trust for the benefit of all debenture-holders, because failing that the Court will interfere and appoint its own receiver (*Stuart* v. *Maskelyne Typewriter &c. Co.,* (1898) 1 *Ch.* 133). Usually trust-deeds declare that the receiver appointed by the debenture-holders or the trustee will act as the agent of the company. In this case he does not become the agent of the debenture-holders unless debenture-holders or their trustees who appointed him authorise him to pledge the credit of the debenture-holders (*Gosling* v. *Gaskell,* (1897) *A. C.* 575; *Cox* v. *Hickman,* (1860) 8 *H. L. C.* 268). If the debenture deed does not contain a statement that he should act as the agent of the company and when he was appointed there was no such declaration, the receiver can pledge the credit of the debenture-holders (*Robinson Printing Co.* v. *Chic,* (1905) 2 *Ch.* 123). Of course if the company goes into liquidation and the receiver is appointed as agent of the company, his agency ceases on such liquidation or on happening of that event. In such cases the receiver must obtain fresh authority from debenture-holders to carry on the business, otherwise he would be personally liable (*Gosling* v. *Gaskell,* (1897) *A. C.* 575). Where a debenture-holder or his trustee has omitted to declare the receiver the agent of the company at the time, even then he can act as their agent so far as is necessary to enable him to exercise his powers as a receiver conferred on him by the debenture or the trust-deed (*Robinson Printing Co.* v. *Chic,* (1905) 2 *Ch.* 123; *Deyes* v. *Wood & others,* (1911)

1 *K. B.* 806). When a receiver appointed by the Court appointed an agent to sell property and did not ask for sanction of Court for appointing the agent to procure purchaser and the agent procured the purchaser and the agent applied to Court for order directing the receiver to pay him the commission, the Court held that as the receiver had not obtained sanction to employ the agent, he was not entitled to any commission, but the Court had the discretion to award him such compensation as the Court considered just in the circumstances of the peculiar case (*In re. National Flying Services Ltd., Cousins* v. *The Company,* (1936) 1 *Ch. D.* 271, (1935) 52 *T. L. R.* 37). Parties thus dealing with the receivers should first ascertain for whom he is acting, *i.e.*, where he is acting as the agent of the company or the debenture-holders, because on that the chances of recovering their money will largely depend in case of appointment of a receiver by the debenture-holders. This is because where the receiver is appointed to act as the agent of the company, it is most undesirable to allow him any credit, because the outside creditor will be in a very difficult position in connection with recovery of his claim from the company's assets which are in most cases fully mortgaged or charged by the debenture trust-deed. A receiver of course is bound to pay out first from the assets of the company those debts of the company which are laid down by the Indian Companies Act to be preferential payments, because if he distributes the assets or uses them up without providing for these preferential payments, he would render himself liable personally (*Woods* v. *Winskill,* (1913) 2 *Ch.* 303; *Westminster Corporation* v. *Chapman,* (1916) 1 *Ch.* 161). In one case a duly appointed receiver having been deceived by an agent of a debenture-holder to pay him in priority to and refusing payment of a local authority's claim for rates, it was held that the receiver was entitled to enforce an indemnity, he had taken from the agent and to require the debenture-holder to refund the money paid. (*Westminster City Council* v. *Treby,* (1936) 2 *Ch. D.* 21).

Of course, the costs and expenses of the receiver and his remuneration and the cost of winding up come before the preferential payments or preferential creditors (*Glyncorrwg Colliery Co., In re.,* (1926) 1 *Ch.* 951).

Sections of Trustees and Mortgagees' Powers Act, 1866 dealing with the appointment, powers and duties of receivers are given as follows :—

Appointment of receiver.

12. Any person entitled to appoint or obtain the appointment of a receiver as aforesaid may, from time to time, if any person or persons has or have been named in the deed of charge for that purpose. appoint such person or any one of such persons to be receiver, or if no person be so named, then mav by writing delivered to the person or any one of the persons entitled to the propertv subject to the charge, or affixed on some conspicuous part of the property, require such last-mentioned person or persons to appoint a fit and proper person as receiver, and if no such appointment be made within ten days after such requisition, they may in writing appoint any person he may think fit.

No person shall be eligible for the office of receiver merely because he is an officer of the High Court.

Receiver deemed agent of the mortgagor.

13. Every receiver appointed as aforesaid shall be deemed to be the agent of the person entitled to the property subject to the charge, who shall be solely responsible for his acts or defaults, unless otherwise provided for in the charge.

Powers of receiver.

14. Every receiver appointed as aforesaid shall have power to demand and recover and give effectual receipts for all the rents, issues, and profits of the property of which he is appointed receiver, by suit, distress, or otherwise, in the name either of the person entitled to the property subject of the charge, or of the person entitled to the money secured by the charge, to the full extent of the estate or interest which the person who created the charge had power to dispose of.

Receiver may be removed and new receivers appointed.

15. Every receiver appointed as aforesaid may be removed by the like authority, or on the like requisition as before provided with respect to the original appointment of a receiver, and new receivers may be appointed from time to time.

Receiver to receive commission not exceeding five per cent.

16. Every receiver appointed as aforesaid shall be entitled to retain out of any money received by him, in lieu of all costs, charges, and expenses whatsoever such a commission, not exceeding five per centum on the gross amount of all money received, as shall be specified in his appointment, and if no amount shall be so specified, then five per centum on such gross amount.

Receiver to insure if required.

17. Every receiver appointed as aforesaid shall, if so directed in writing by the person entitled to the money secured by the charge, insure and keep insured from loss or damage by fire out of the money received by him, the whole or any part of the property included in the charge which is in its nature insurable.

Application of money received by him.

18. Every receiver appointed as aforesaid shall pay and apply all the money received by him in the first place in discharge of Government revenue, and of all taxes, rates, and assessments whatsoever, and in payment of his commission as aforesaid, and of the premiums on the insurances, if any; and in the next place in payment of all interest accruing due in respect of any principal money then charged on the property over which he is receiver, or on any part thereof; and subject as aforesaid, shall pay all the residue of such money to the person for the time being entitled to the property subject to the charge, his executors, administrators, or assigns.

This part to relate to charges by way of mortgage only.

19. The powers and provisions contained in Sections 6 to 18 of this Act, both inclusive, relate only to mortgages or charges made to secure money advanced or to be advanced by way of loan, or to secure an existing or future debt.

Deposit of Debentures with Bankers

It is the frequent practice of bankers to receive debentures from the companies in deposit to secure advances from time to time on current account, and as we have already shown elsewhere, the said debentures will not be taken to be redeemed by reason only of the current account having ceased to be in debit. It should however be noted that if a subsequent mortgage is created on the same property mortgaged under debentures, and the banker has notice of same, he cannot make further advances on the security of these debentures to the prejudice of the latter mortgage. On the contrary, in case he keeps the current account open and running and the company pays in money, all these amounts paid in by the debtor company will go to reduce the original debt according to the rule in what is known as the *Clayton's Case,* (1816) 1 *Mer,* 527 which will apply (*Florence Deeley* v. *Lloyds Bank Ltd.*. (1912) *A. C.* 756). It may be added that the rule would apply in case of advances on deposit of title-deeds of land in case banker makes further advances after notice of sale of the land (*London and County Banking Co. Ltd.,* v. *Thomas Ratcliffe,* (1881) 6 *Ap. C.* 722). The wisest course therefore, from the bankers' point of view, is to rule off and close the current account with a view to preserve his claim intact on the original mortgage. A separate current account may be opened for subsequent payments in by the debtor company.

Reissue of Redeemed Debentures

Before our Act of 1913 and the English Companies Act of 1907 the law was in a very unsatisfactory condition as to the reissue of debentures, as the company after it had once paid off its debentures or any part of them could not keep them alive in order to reissue them, nor could it issue fresh debentures with rights ranking *pari passu* with the holder of the original series, unless the terms of the original issue authorised this to be done. This caused great hardship because the practice of borrowing on deben-

tures from bankers and others is most common among companies, particularly trading companies, with the result that the law was amended by Sec. 15 of the English Act of 1907, re-enacted in Sec. 104 of 1908 which was bodily taken up in our Sec. 127 of the Indian Companies Act of 1913. Now where either before or after the commencement of this Act (thus making the law retrospective as well as of future application) a company has redeemed debentures which it had issued previously it can with certain exceptions, keep them alive for the purposes of reissue and where a company has purported to exercise such a power the company shall have power and shall be deemed always to have had power to reissue the debentures either by reissuing the same debentures, or by issuing other debentures in their place, and upon such reissue the person entitled to the debentures shall have and shall be deemed always to have had the same rights and priorities as if the debentures had not previously been issued.

The two exceptions are where (1) articles or the conditions of issue expressly otherwise provide, or (2) the debentures have been redeemed in pursuance of any obligation on the company so to do, not being an obligation enforceable only by the person to whom the redeemed debentures were issued or his assigns.

The first point is easy to follow, *viz.*, when the articles expressly forbid such a reissue. In the second case say where the agreement is that so many per year shall be paid off they cannot be reissued. " Not being an obligation enforceable only by the person to whom the redeemed debentures were issued or his assigns " cover the case where the debenture has been deposited to cover a temporary advance and the loan is called in. Here the company can keep same alive and reissue.

Transfer of Debentures

In case of debentures to bearer there is of course no difficulty as to transfer, because they are transferable by delivery, but where the debentures are registered debentures

and the certificates are issued in the names of the holders, which names are registered in a special register of debenture-holders at the office of the company, they are transferable only in the manner specified in the conditions endorsed on them or according to the terms and conditions to be found in the debenture trust-deed. Usually, these conditions lay down that transfer of the debenture must be in writing under the hands of the registered holder or his personal representative. This transfer, the regulation requires, must be registered at the registered office of the company duly stamped and accompanied with a fee of one rupee, or such other fee that may be fixed and such evidence of identity or title as the company may reasonably require. The company thereafter registers this transfer in its register of debenture-holders. The regulation also provides that the instrument of transfer shall be in such form as the company shall from time to time prescribe and that the transfer shall be retained by the company. The company's responsibility in connection with the registration of debentures is great, particularly where the transfer happens to be forged. After a resolution for voluntary winding up has been passed, a debenture-holder who is also a shareholder, can only assign the debenture subject to future calls (*In re. China Steamship Co.*, (1869) 7 *Eq.* 240; *Partridge* v. *Rhodesia Goldfields*, (1910) 1 *Ch.* 239); but where the debenture is transferable free from equities, this will not arise. A transfer of debenture made by one of the several joint holders in which the holder signed his own name and forged the signature of his joint holders is void and ineffective (*Cottam* v. *Eastern Counties Ry. Co.*, (1860) 1 *Joh. & H.* 243). The practice in the offices of the company as to transfer of debentures is almost along the same lines as in case of shares and the secretary or officer in charge of this department has to carefully go through similar formalities as in case of transfer of shares. Debentures can be transferred in blank unless the regulations of the company require these transfers to be under seal (*Hibblewhite* v. *McMorine*, (1840) 6 *M. & W.* 200). This is for the simple

reason that a deed must be complete before it is executed.

Exchange of Debentures for Shares

There is no objection in connection with this exchange so far as debentures are not issued at a discount and are exchanged at the full value, because that would be an illegal process, as the company will not get full value for its shares and it will be taken by the Court as an excuse to issue shares at a discount in disguise (*Moseley* v. *Koffyfontein Mines*, (1904) 2 *Ch.* 108). In another case it was held that where a bonus is to be given to debenture-holders out of profits and there were no profits, fully paid shares cannot be issued in lieu of the bonus (*Bury* v. *Famatina Development Corporation*, (1910) *A. C.* 439). As this issue of shares against debentures amounts to a issue of shares for a consideration other than cash, a contract in writing would be necessary with the certified copy filed with the registrar.

Meetings of Debentrue-holders

It has now become a universal practice in connection with the issue of debentures to mention in the trust-deeds, the circumstances under which the meetings of debenture-holders may be convened and the questions which they are qualified to direct upon. Here the rules of procedure in connection with these meetings of debenture-holders are clearly stated in form of one of the schedules to the debenture trust-deed. Generally, the trustees are given the power to convene such meetings of debenture-holders when they deem necessary or on requisition in writing of the holders of one-fifths or more of the nominal amount of debentures for the time being. It is further provided that whenever the company is about to convene any such meeting, a notice should also to be given forthwith to the trustees of the place, day and hour at which such meeting is to be held and the nature of business which is to be done there. This schedule as to meetings

of debenture-holders provides for a notice to the debenture-holders to be given a certain number of days prior to the date of the meeting, usually seven, at which meeting a quorum has to be present, which quorum is also fixed by its rules which is usually of one-fifths of the nominal amount of the debentures for the time being outstanding against the company. The rules may provide for the appointment of a chairman by the trustees or by the meeting of debenture-holders themselves and give permission to the trustees and their solicitor or directors or secretaries of the company or their solicitor to attend such meeting. The usual rule is that if the quorum is not present within 15 minutes of the time for calling the meeting, the same shall stand adjourned within a certain specified period and if at that adjourned meeting the quorum is not present, the debenture-holders present shall form a quorum and may transact business in the usual way.

The usual provisions that in the first instance questions are to be decided by a show of hands and that if a poll is demanded the same shall be given, are inserted. Usually three debenture-holders at least must ask for a poll, though the number may by rules be increased or lessened. Powers are then given to the chairman to adjourn the meeting with the consent of the meeting or to take the poll at his option without adjournment or fix up a future date for same. The position and voting power of holders of these bearer debentures are also regulated by these rules. In connection with poll, the usual regulation is that each debenture-holder may have one vote in respect of a certain principal sum, say, Rs. 500 or Rs. 1,000 secured by the debentures which he holds for which he has been registered as a holder on the debenture register. The rules also lay down various acts which the general meeting of debenture-holders may by an extraordinary resolution do such as

(1) sanction the surrender or release of mortgaged premises,

(2) sanction compromise and arrangements to be made between a company and debenture-holders,

(3) sanction any modification of the rights of debenture-holders against the company or against its property,

(4) assent to any modification of the provisions of the rules which may be proposed by the company and agreed to by the trustees.

The extraordinary resolution is also defined by the rules as three-fourths of the debenture-holders voting at a meeting, duly convened, either upon a show of hands or if poll be demanded, by a majority consisting of not less than three-fourths of the votes given on such a poll. A special rule provides for the keeping of proper minutes of the resolutions and proceedings at every such meeting in a book specially kept for the purpose by the trustees at the expense of the company and that such minutes if signed by the chairman of the meeting at which such resolution was passed, or by the chairman of the next succeeding meeting of the debenture-holders, shall be conclusive evidence of the matters therein contained and until the contrary is proved such meeting in respect of the proceedings of which minutes have been made, shall have been duly held and convened and all resolutions passed thereat or proceedings taken should have been duly passed and taken.

In connection with the above regulations, it must be remembered that it has been decided that a power to release mortgaged premises or to compromise on their rights by the debenture holders, will not include the power to relinquish the company altogether from its obligations, neither does it include the power to exchange debentures for shares in another company (*Mercantile Investment Co.* v. *River Plate Loan Co.*, (1894) 1 *Ch.* 578; *Walker* v. *Elmore's German Meal Co.*, (1901) 85 *L. T.* 767; *Sneath* v. *Valley Gold Co.*, (1893) 1 *Ch.* 477), In short, the power to compromise does not mean a power to make present. Generally speaking, the modifications ought to be on the footing that it improves the position of the

company. In *Mercantile Investment Co.* v. *International Co. of Mexico,* (1893) 1 *Ch.* 484 it was laid down that if authority is given to make any modification or arrangement that would mean a wider power than if only the word compromise was used and if terminable debentures are either extended or made perpetual, the compromise would be in their powers (*Northern Assurance Co.* v. *Farnham United Breweries,* (1912) 2 *Ch.* 125). There are cases where debentures are issued against security for a loan of money to bankers or money lenders which are of larger value than the actual loan advanced. Here the question arises as to whether their voting power is restricted to the amount they have actually advanced. Here it is laid down that they can exercise the voting power to the full face value of these debentures (*British America Nickel Corporation* v. *O'Brien,* (1927) *A. C.* 369). We have seen above that the notices are provided for in the regulations in the trust-deed as to meetings. If no such notices are to be provided for to be given to individual debenture-holders, notice by advertisement will be sufficient and will be taken to have been given on the day on which the advertisement appears in the papers (*Sneath* v. *Valley Gold Co.,* (1893) 1 *Ch.* 477).

A joint stock company holding debentures in another company can exercise its voting power through the medium of one of its directors or officers duly authorised by the board of directors to represent it at the debenture-holders' meeting. It is of course better to provide this in the rules for the meeting of debenture-holders in the trust-deed as otherwise unnecessary disputes might arise. Under rules, powers can also be given to the debenture-holders by an extraordinary or some other resolution to agree to an exchange of all the debentures, for debentures in another company (*Hutchnison & Sons,* (1915) 31 *T. L. R.* 324).

Debenture-holders' Remedies

When the debentures are only unsecured debentures,

the debenture holder is, as we have seen, an ordinary creditor of the company and all that he can do is to sue for his interest or principal that falls due, obtain decree of the Court in due course and attach any property of the company under the said decree. The other remedy is for him either before or after judgment to present a petition in winding up or in case the winding up has already commenced to prove his claim as an unsecured creditor.

If however the debentures carry a mortgage or charge, as they usually do now, the debenture holder has usually almost all the powers which the mortgagee has in his debenture trust-deed. If powers are insufficient, he can sue the company as regards principal and interest with a view to enforce his security (*Rogers & Co.* v. *British & Colonial C. S. Association,* (1899) 68 *L. J. Q. B.* 14). A single debenture-holder can sue on behalf of himself and his brother members of the same class under these circumstances and the Court may appoint a receiver or manager as it may deem best. When however there is a trust-deed, not much difficulty is experienced if the same is (as we have seen before) properly drafted, because there, most of the powers available to the debenture-holders with the assistance of the Court may be provided for without such assistance being requisite.

Debenture-holders' Action

Where the trust-deed is not properly drawn out and does not provide for the power of sale, either trustees or one of the debenture holders on behalf of himself and all the brother debenture holders, can apply to the Court by what is known as a debenture holders' action for the appointment of a receiver and the sale of the property by the Court. In such actions, necessary parties will be the company as well as the trustees if there is a trust-deed and any other mortgagee known to the debenture holder suing (*Wilcox & Co.,* (1903) *W. N.* 64). A debenture holder thus suing on behalf of himself and others can stop the action when he chooses, *e.g.,* on his claim

being satisfied (*Ward* v. *Alpha Co.,* (1903) 1 *Ch.* 203). However, in such cases the Court interferes if these debenture holders' interest are in conflict with other debenture holders and may transfer the conduct of proceedings to some other independent debenture holder (*The Services' Club Estate Syndicate Limited,* (1930) 1 *Ch.* 78). A debenture holder also suing on behalf of himself and other debenture holders cannot compromise or give away rights of other debenture holders (*Re. Calgary & Medicine Hat Co.,* (1908) 2 *Ch.* 659; *Smith* v. *Law Guarantee and Trust Society,* (1904) 1 *Ch.* 500). The debenture holder in an action of debenture holders usually asks for the declaration of the charge, the determination of the actual property so charged, sale and appointment of receiver or if necessary, manager. When there are different sets of debenture holders with different rights, a declaration of enquiry as to the different types of debenture holders and their rights on various properties charged is also asked for. Even where a company is in liquidation, a debenture holder may, instead of bringing an action take out a summons for declaration of his charge and realisation of his security (*Colonial Trusts Corporation,* (1880) 15 *Ch. D.* 465). The application of debenture holders to enforce the security may be made by originating summons (*General South American Co.,* (1876) 2 *Ch.* 337). Where the assets of the company are insufficient to pay fully the debentures of the class on whose behalf the action was brought, the usual practice is to give the debenture holder bringing his action his full cost on the solicitor and client basis out of the assets (*Wright* v. *Kirby,* (1857) 23 *Beav.* 463; *Carrick* v. *Wigan Tramways Co.,* (1893) *W. N.* 98; *Mortgage Insurance Corporation* v. *Canadian Agricultural Coal Co.,* (1901) 2 *Ch.* 377). In case of the company and subsequent mortgagees or encumbrancer who is sued by the debenture holder as necessary party, they can get their cost only out of the surplus after paying the mortgagee or encumbrancers (*Wilcox & Co.,* (1903) *W. N.* 64; *Re. Clayton Engineering Co.,* (1904) *W. N.* 28). Of course, the cost being at the

discretion of the Court in some exceptional cases where they have been of particular assistance in the realisation of assets, Court may allow them their cost.

When the security is enforced and sale is made, the proceeds have to be applied in the following manner:—

(1) Expenses in realisation of the security,

(2) Remuneration and expenses of the receiver, if any,

(3) Expenses and costs properly incurred by trustees for debenture holders,

(4) Debenture holders cost for action on behalf of himself and other debenture holders to enforce security,

(5) The amount due by way of principal and interest to debenture holders,

(6) The surplus would go to subsequent mortgagees and encumbrancers and failing that to the company.

Debenture holders who have been paid cheques for their interest, but have not cashed them prior to liquidation are treated as secured creditors for the amount of interest covered by these cheques (*Eichholtz* v. *Defries & Sons.* (1909) 2 *Ch.* 423). A debenture holder from whom money is due to the company is not entitled to a dividend on his debentures unless he pays in what he owes to the company (*Farmer* v. *Goy & Co.*, (1900) 2 *Ch.* 149). This applies even to those who have purchased the debentures from the debenture holders, *i.e.*, they cannot also receive the dividends until the amount due to the company is made good by the transferor, if the transfer happens to have been made after the appointment of the receiver.

The principle to be followed carefully is that in case of debenture holders' action, which should be taken up by a debenture holder against whom the company has no right of set-off and whose debentures are otherwise unimpeachable (*Huggons* v. *Tweed,* (1879) 10 *Ch. D.* 359; *Bart* v. *British Nation Life Assurance,* (1859) 4 *De G. & J.* 158). The debenture holder can of course represent himself and other debenture holders of his class when they are more than one class of debenture holders and in the latter case the trustees of other debenture holders through a covering deed securing the other debentures should also be made

parties (*Mortgage Insurance* v. *Canadian Agricultural*, (1901) 2 *Ch.* 377). Where actions are simultaneously brought by two or more debenture holders, the usual practice of the Court is to stay all actions except that of one debenture holder, particularly the first (*Re. Swire,* (1882) 21 *Ch. D.* 647). However if the action of the first debenture holder is defective, he may not get the conduct of his action (*Re. Macrae,* (1884) 24 *Ch. D.* 16). The same will be the case in case the debt is doubtful (*Re. Ross,* (1907) 1 *Ch.* 482).

Forms of Documents in Connection with issue of Debentures

The forms in connection with the issue of debentures, *viz.,* precedents of prospectus, forms of application by debenture-holders are given in Vol. II.

Alterations of Memorandum sometimes made with a view to Facilitate the issue of Debentures

There are cases and actions on which the Memorandum of Association has to be altered with a view to facilitate the issue of debentures and in this connection naturally the objects clause is the clause whose alteration has to be taken in hand. The sub-clauses of Sec. 12 (1) of the Indian Companies Act are the clauses under which these alterations must fall. Under Sec. 12 (1) (a) alterations have been allowed to companies formed for the purpose of purchasing reversions and for investing its specified securities to enable them to issue debentures and give as security the company's property. This was done under this sub-clause on the ground that it enabled the company to carry on its business more efficiently (*Reversionary Interest Society,* (1892) 1 *Ch.* 615; *Government Stock Investment Co., No.* 2, (1892) 1 *Ch.* 597).

Blank Debentures

Though of course it is very rare, debentures in blank are issued, *i.e.,* with the names of holders

left blank. These debentures will have to be stamped on the footing of debentures to bearer and strictly on the footing of their being deeds, as they are to be issued under the seal of the company. The legality of this type of debentures is of considerable doubt, though it has been held that the contract to issue them, which is implied, will be effectual in equity to protect the owner (*Re. Strand Music Hall Co.,* (1865) 3 *De. G. J. & S.* 147; *Davis* v. *Martin,* (1894) 3 *Ch.* 181; *Reeves* v. *Watts,* (1866) *L. R.* 1 *Q. B.* 412; *Queensland Land & Coal Co.,* (1894) 3 *Ch.* 181). These debentures in simple language are said to be good in equity, though bad in law. When the loan which is raised on the security of such debentures is paid off, the debentures would in natural course get exhausted.

Redemption of Debentures

In case of debentures which are to be redeemed the company can do so either by paying them direct itself or by a short cut by a purchase from the market if that is more favourable. Of course, if debentures are purchased cheaper, the company would make a profit which would belong to it and which the company would be entitled to deal with in the usual way it does with its net profits, *i.e.,* either carried to a reserve fund or added to the balance of net profits ready for division among shareholders, by way of dividends. This rule of course applies to a trading company (*Wall* v. *London & Provincial Trust,* (1920) 1 *Ch.* 45). We have already seen that a redemption under any circumstances falls due on liquidation, but in all other cases, it would depend upon the terms of the issue and for that purpose provision either in the debenture certificates themselves or in the deeds constituting the debentures must be made. The other cases where the debenture-holder can insist upon redemption of debentures, apart from the agreement in connection with its issue, are where a company parts with the whole of substantially the whole of its undertaking and stops as a going concern

(*Hubbuck* v. *Helms*, (1887) 56 *L. J. Ch.* 536). Of course if the memorandum of association provides otherwise, the position would be different, because in that case the creditor would know that the company had the power to sell its whole concern (*Re. Borax Co.*, (1901) 1 *Ch.* 326). If the conditions of issue or the debenture deed expressly provides for the redemption of debenture on a particular date, then there is no difficulty and on expiry of that date, the debentures become immediately payable (*Tewkesbury Gas Co.*, (1911) 2 *Ch.* 279; *affirmed* (1912) 1 *Ch.* 1). In the same case it was decided that the prospectus which was issued in connection with the debentures could not be looked into to see what terms were agreed to, particularly where the terms are other than those laid down in the debenture trust-deed or in the debenture certificates themselves. If the clause with regard to the payment of debentures lays down that the said clause can only be enforced at the option of the covenantors, the same would be void but if the clause states that the debentures are payable on or after a particular date, that would be in order (*Tewkesbury Gas Co.*, (1911) 2 *Ch.* 279; *affirmed* (1912) 1 *Ch.* 1). This principle was also laid down in the *Tewkesbury Gas Co.'s Case* referred to above. The other principle was that on the debentures becoming due, when made payable on or after a particular date, any debenture holder can give notice demanding the money. If one of the clauses lays down that on the happening of a certain event, the debenture would be payable and if that event happens to be under the control of the company, the company cannot deliberately bring about such an event compelling the debenture holders to accept immediate payment (*General Motor Cab Co.*, (1912) 56 *S. J.* 573). However, any condition which is a clog on the company's power to redeem its mortgaged property, whether the mortgage be a fixed mortgage or a floating mortgage, the same would be void (*Kreglinger* v. *New Patagonia Meat Co.*, (1914) *A. C.* 25). Where a winding up follows the debenture holders are entitled to enforce the charge and

obtain payment even though the debentures have not matured (*Hodson* v. *Tea Co.*, (1880) 14 *Ch. D.* 859; *Wallace* v. *Universal Automatic Machine Co.*, (1894) 2 *Ch.* 547).

In this connection Sec. 126 of Indian Companies Act lays down as follows:—

"A condition contained in any debentures or in any deed for securing any debentures, whether issued or executed before or after the passing of this Act, shall not be invalid by reason only that thereby the debentures are made irredeemable or redeemable only on the happening of a contingency, however remote, or on the expiration of a period, however long."

The above section no doubt provides for the issue of perpetual debentures without making them invalid for the reason of perpetuity alone. Power is also given by Sec. 127 of the Indian Companies Act, 1913 to companies purchasing their own debentures, which thereupon become extinguished unless the company desires to keep them alive. Thus the perpetual or irredeemable debentures are said to be not mortgages but annuity in perpetuity to the holder.

In connection with collateral advantages stipulated on the issue of debentures, these advantages may continue not only during the currency of the loan, but if so stipulated for, they may even continue after the payment subject to that, there has been no unfair dealing and there is no attempt to prevent the mortgagor from getting back his mortgaged property (*Kreglinger* v. *New Patagonia Meat Co.*, (1914) *A. C.* 25). On this principle in *re. Cuban Land Co.*, (1921) 2 *Ch.* 147 debenture holders were allowed to receive the stipulated one-third surplus assets of the company in case of winding up even though meanwhile they had been paid off and the debentures extinguished.

Frequently debentures are issued at a premium, in that case on redemption the money lent plus the amount of the premium will be the secured amount (*Rowell & Son* v. *Inland Revenue Commissioners*, (1897) 2 *Q. B.* 194).

The usual law of mortgage and mortgagee would apply in case where the mortgagees have made repairs which the mortgagor was bound to do and failed to carry out, *viz.*, that the money so spent will be considered as a charge on the property mortgaged and will have to be repayable on that footing (*Suffield* v. *Inland Revenue Commissioners*, (1908) 1 *K. B.* 865). There are conditions also in the debentures which must be specifically stated either in the debenture certificate or in the debenture deed by which a place is mentioned where the debentures are payable. This clause is a very necessary clause as otherwise according to the ordinary rules of debtors and creditors, the company would have as a debtor to find out its creditor wherever he may be and pay him the amount due and meanwhile keep on paying interest even though the principal remains unpaid through the carelessness of the debenture holder not presenting his debentures for payment in time (*Fowler* v. *Midland Electric Corporation for Power Distribution*, (1917) 1 *Ch.* 656 *C. A.*). In other cases the company takes power to remit the interest on the capital by a cheque to the debenture holders to their registered address as the more convenient method for arranging payment and the conditions lay down that any loss in so sending under registered cover will fall on the debenture holder. The interest on debentures accrues *de die in dien* (*Re. Rogers*, (1863) 1 *Dr. & Sm.* 338). Where the amount due on a debenture is made payable by instalments, the usual condition provides that on non-payment of any instalment, the company will cancel the debenture and forfeit the instalments already paid. This is of course subject to this that if there is a winding up petition pending before any such instalment is due and payable, the debenture holder may withhold payment of his instalment for the time being to watch the events and for doing so will not by reason of his non-payment render his previous payment liable to forfeiture or in any other way enforce his rights or security (*Ellerby's Claim*, (1872) 20 *W. R.* 855).

Garnishees and Floating Debentures

If a judgment creditor of the company obtains a garnishee order on a debt owing to the company, he will not get a priority to the floting debenture holders' security if it has attached. This was held on the ground that a service of garnishee order *nisi* did not operate as an assignment in equity or amount to a transfer of the debt (*Norton* v. *Yates,* (1906) 1 *K. B.* 112). This principle is held to apply even in cases where, after the garnishee order absolute is served, the company honestly and without fraud or collusion, issues debentures for valuable consideration which attached, the debenture holder would prevail (*Geisse* v. *Taylor & Hartland,* (1905) 2 *K. B.* 658). The point is that even though the sheriff has sold the property which he has executed and the money remains in his hand, the debenture holder can by taking immediate action preserve their security (*Re. Opera Ltd.,* (1891) 3 *Ch.* 260; *Taunton* v. *Sheriff of Warwickshire,* (1895) 2 *Ch.* 319). The correct course is that as soon as the debenture holders or trustees find that an execution has been put in, they should give notice to the sheriff to withdraw, or to the debtor not to part with the money to the Garnishor and immediately take steps to appoint a receiver and make the security a fixed security before the goods are sold and money paid out (*Davey* v. *Williamson,* (1898) 2 *Q. B.* 194; *Evans* v. *Rival Granite Quarries,* (1910) 2 *K. B.* 979). Here the object sought to be achieved is to get the floating security of the debenture holder crystallised before the sheriff or the garnishor takes advantage of his execution by selling the property and obtaining money in payment of their claims (*Opera Ltd.,* (1891) 3 *Ch.* 260, *Norton* v. *Yates stated above*). The debenture holder must take action immediately and crystallise his security as otherwise the Court will not set aside the rights of the holder of the garnishee order and would make the order *nisi* absolute (*Evans* v. *Rival Granite Quarries,* (1910) 2 *K. B.* 979).

Interest on Debentures

The debenture deeds always provide for the payment of interest at a certain rate and at fixed interests, failing which the common law rule of no interest being payable on a debt unless expressly agreed will apply. We have already seen above that failing the mention of a place of payment, the company would have to pay interest to the holder at his place. Sometimes, though rarely, interest is by special contract made payable only out of profits. These are called " income bonds " and in their case nothing can be taken to the reserve fund until all interest due is paid (*Heslop* v. *Paraguay C. Ry.*, (1910) 54 *Sol. J.* 234).

CHAPTER XV

Banking Companies

The Indian Companies (Amendment) Act, 1936, deals with Banking Companies specifically in a special compartment of the Act, *viz.*, Part XA owing to "the peculiar nature of the business and the different interests which require protection." The sections under this part aim at the protection of depositors and also provide against the launching of mushroom banking companies with inadequate finance, restriction of banking companies as far as possible to banking transactions only, ensuring of the maintenance of the proper reserve fund with proper cash reserve, restrictions on granting of loans to officers including directors and auditors, providing of protection to the banks themselves in the nature of moratorium, prevention of managing agencies in the organisation of banking companies, etc.

The Act has boldly defined in some detail the "Banking Company" and within the fold of the said definition has extensively enumerated the various functions which such banking companies can perform as given hereunder.

Definition

A 'Banking Company' means a company which carries on as its principal business the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order, notwithstanding that it engages in addition in any one or more of the following forms of business, namely :—

(1) the borrowing, raising or taking up of money; the lending or advancing of money either upon or without security; the drawing, making, accepting, discounting, buying, selling, collecting

and dealing in bills of exchange, hoondees, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scrips and other instruments, and securities whether transferable or negotiable or not; the granting and issuing of letters of credit, travellers cheques and circular notes; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange including foreign bank notes; the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds; the purchasing and selling of bonds, scrips or other forms of securities on behalf of constituents or others; the negotiating of loans and advances; the receiving of all kinds of bonds, scrips or valuables on deposit, or safe custody or otherwise; the collecting and transmitting of money and securities;

(2) acting as agents for Governments or local authorities or for any other person or persons; the carrying on of agency business or any description other than the business of a managing agent including the power to act as attorneys and to give discharges and receipts.

(3) contracting for public and private loans and negotiating and issuing the same;

(4) the promoting, effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue, public or private, of State, Municipal or other loans or of shares, stock, debentures, or debenture stock of any company, corporation or association and the lending of money for the purpose of any such issue;

(5) carrying on and transacting every kind of guarantee and indemnity business;

(6) *promoting or financing or assisting in promoting or financing any business undertaking or industry, either existing or new, and developing or forming the same either through the instrumentality of syndicates or otherwise;*

(7) *acquisition by purchase, lease, exchange, hire or otherwise of any property immoveable and any rights or privileges which the company may think necessary or convenient to acquire or the acquisition of which in the opinion of the company is likely to facilitate the realisation of any securities held by the company or to prevent or diminish any apprehended loss or liability;*

(8) *managing, selling and realising all property moveable and immoveable which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;*

(9) *acquiring and holding and generally dealing with any property and any right, title or interest in every property moveable or immoveable which may form part of the security for any loans or advance or which may be connected with any such security;*

(10) *undertaking and executing trusts;*

(11) *undertaking the administration of estates as executor, trustee or otherwise;*

(12) *taking or otherwise acquiring and holding shares in any other company having objects similar to those of the company;*

(13) *establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts, and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pensions and allowances and making payments towards insurance; subscribing to or guaranteeing moneys for charitable*

or benevolent objects or for any exhibition or for any public, general or useful object;

(14) the acquisition, construction, maintenance and alteration of any buildings or works necessary or convenient for the purposes of the company;

(15) selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;

(16) acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this section;

(17) doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company. (S. 277 F).

No Company which is formed after the commencement of the Indian Companies (Amendment) Act of 1936 for the purpose of carrying on business as a banking company or which uses as part of the name under which it proposes to carry on business the word " Bank," " Banker " or " Banking," shall be registered under the Act unless its Memorandum limits the objects of the company within the folds of the above definition. The Act goes further and lays down that no banking company whether Incorporated in or outside British India shall after the expiry of two years from the commencement of the Indian Companies (Amendment) Act of 1936, carry on any form of business other than those specified in the above definition. Provided that the Governor-General in Council may by notification in the Gazette of India, specify in addition to the businesses set forth in the said definition other forms of business which it may be lawful under this section for a banking company to engage in (S. 277 G). Thus for all banking companies two years limit is given within which they have to adjust their position to fall within the definition of the Act. The other provision is that after the expiry of two years from the

commencement of the Act a banking company cannot employ or be managed by a managing agent other than a banking company for the management of the company. (S. 277 H). Thus the managing agency is prohibited in case of banking companies with the above exception. The other requirement is that a banking company, after the commencement of the said Act, cannot commence unless shares have been allotted by it to an amount sufficient to yield a sum of at least Rs. 50,000 as working capital and unless a declaration duly verified by affidavits signed by the directors and managers that such a sum has been received by way of paid-up capital has been filed with the Registrar. (S. 277 I). A banking company is now prohibited from mortgaging or charging its unpaid capital and if such a charge is created, the same is declared to be void. (S. 277 J). Every banking company after the commencement of the Act must create, out of the profits declared each year, a reserve fund before any dividend is declared by transferring from profits a sum equivalent to not less than 20 per cent. of such profits to the reserve fund until the amount of the reserve fund is equal to the paid-up capital. The amount standing to the reserve fund of a banking company is to be invested in government securities or any securities mentioned or referred to in Section 20 of the Indian Trustees Act, 1882 or can be deposited in a special account to be opened by the company for the purpose in a scheduled bank. This provision as to investment of reserve fund does not apply to a banking company incorporated before the commencement of the Indian Companies (Amendment) Act of 1936 till after the expiry of two years from the commencement of the said Act (S. 277 K). Over and above this all banking companies in India must maintain by way of cash reserve a sum equivalent to at least 1½ per cent of time liability and 5 per cent of the demand liability of such companies and must file with the registrar before the 10th day of every month a statement of the amount so held on the Friday of each week of the preceding month with particulars of the demand liabilities

of each such day. This requirement, however, is not to apply to scheduled bank as defined in Sec. 2(e) of the Reserve Bank of India Act, 1934, which is dealt with a little later in this chapter. In case any default is made in connection with maintenance of a cash reserve, the directors and officers knowingly and wilfully a party to the default are liable to a fine not exceeding five hundred rupees for every day during which the default continues and in case of default as to the filing of the statement with the registrar to a fine not exceeding one hundred rupees for every day during which the default continues (Sec. 277L). A banking company is also prohibited from forming or holding the shares in any subsidiary company except its own subsidiary formed for the purpose of undertaking and executing trusts, undertaking the administration of estates as Executors and Trustees or otherwise and such other purpose as set forth in the definition of a banking company under the Act. (Sec. 277M).

In the case of banking companies which are temporarily unable to meet their obligations the Court has power to make an order staying the commencement or continuance of actions and proceedings against it for a fixed period of time on terms and conditions as the Court may think fit. This is done with a view to protect a banking company against an unexpected run in times of difficulties. This of course is to be done after proper investigation is made by the registrar as to the financial condition of the bank after examining the books and documents and reported on to the Court (Sec. 277N).

RESERVE BANK OF INDIA

It is an item of great satisfaction that at last the Reserve Bank of India Act of 1934 has been passed by our Legislative Assembly and India has now a Central Reserve Bank functioning on most modern lines side by side with similar institutions in other important centres of the world. There may be points on which differences of opinion must prevail in connection with legislation of this character,

but generally speaking, the Bill as framed is satisfactory, except perhaps on the question of fixation of exchange ratio on which public opinion is very sharply divided. It is proposed to clarify here in simple language the salient points as laid down by this important enactment, because to all of us in India the Reserve Bank is the most important financial institution of the country.

WHAT IS A CENTRAL BANK

While proceeding to deal with our subject it is best that we should have a correct perception as to exactly what a central bank is expected to represent by that denomination. A central bank as it has come to be known in every important centre of the world is the principal bank of the country to which are assigned principally the following functions :—

(1) To act as a depository of the Government cash balances and as its financial agent and treasurer in general.

(2) To manage, supervise and direct the currency of the country and to maintain the currency reserve.

(3) As the treasurer or cashier of the State to manage different remittances of the Government and to act generally as a banker of the Government.

(4) To manage the public debts of the country.

According to our Central Banking Commission (Majority) Report, 1931 :—"The two principal tasks of the Reserve Bank will be to maintain the international value of the rupee and to control the credit situation in India, which would include the rate of interest at which credit would be available to trade and industry."

The other peculiarity is that the central bank is not expected generally to do commercial business, or to compete with commercial banks, but generally to act as bankers' bank, *i.e.*, keep accounts of all the principal banks in the country and help them with finances whenever necessary.

Happily the Central Banking Commission is unanimous on this point when they state that :—"We agree that the Reserve Bank should not ordinarily compete with commercial banks for profit."

A central bank not only manages the currency reserve of the state, but also controls the reserves of these commercial banks, with the result that they can manipulate the currency in the interest of the country's credit on the market by tightening the money market by appropriate operations, wherever so desired, by reducing the supply of cash held by the commercial banks. In their valuable work entitled "Central Bank" Kisch and Elkin observe; "The central bank of a country stands in a special relationship to the Government, seeing that by its discount policy and the subsequent reactions on credit, gold reserves and note issues. It controls the amount of purchasing power available, and is thus responsible for safeguarding the currency standard established by law."

A SHAREHOLDER'S BANK

After thoroughly overhauling the question whether our central bank should be a shareholders' bank or a State Bank, the Legislative Assembly has decided in favour of the former. Personally we submit that it is a correct decision in spite of the fact that there was a certain section opposed to our central bank being a shareholders' bank. The reason is that in all the important centres of the world, central banks are generally shareholders' banks, because experience has proved that otherwise the central bank might be overshadowed by the influence of the state and the political parties in power, instead of functioning as an independent institution, as far as it can, under the circumstances that it has to manage the country's currency and to act as a banker to the Government. To a certain extent no doubt Government influence must prevail in connection with the central banking institutions as in every part of the world, but expert opinion is almost unanimous on the point that undue interference by the state can only be most efficaciously avoided by making the bank an independent organisation, giving such specific and limited powers to the state as may be considered essential under the peculiar circumstances by which these Institu-

tions are surrounded. To achieve this, state-ownership should be avoided as far as possible in our opinion, because otherwise such ownership affords " A facile pretext for the exercise of Government pressure." Our central bank under shareholders' ownership functions as a joint stock company under a special Act of the Assembly with the original capital of five crores of rupees divided into shares of Rs. 100 each, which are fully paid. Arrangements are made to maintain separate registers of shareholders at Bombay, Calcutta, Delhi, Madras and Rangoon and a separate issue of shares has been made in each of the areas served by these registers. The object of fixing the areas and the register happens to be to enable the election of representative directors from each of these centres as we shall see a little later.

THE SHAREHOLDER

As to who should be entitled to purchase shares in our Reserve Bank and be registered in that capacity, the Act lays down that no person who is not domiciled in India and is not either an Indian subject of His Majesty or the subject of a state in India or a British subject ordinarily resident in India and domiciled in the United Kingdom shall be a shareholder.

With reference to British subjects of the Dominions, a restriction is laid down, *viz.*, that such a subject shall not be a shareholder in case the Government of that dominion discriminates in any way against Indian subjects of His Majesty. Besides this, a company registered under the Indian Companies Act of 1913 or a Society registered under the Co-operative Societies Act of 1912 or under any other law for the time being in force in British India relating to Co-operative Societies or a Scheduled Bank, a Corporation or a company incorporated by or under the Act of Parliament can be a shareholder. In case of companies and similar institutions registered in the dominions under the British Crown, the same condition as to discrimination in the case cited above is imposed.

The share capital of course can be increased or reduced on the recommendation of the central board with the previous sanction of the Governor General. The sale or allotment of shares at different centres is also regulated according to the importance of each province and thus the shares to the nominal value may be allotted as follows :—

Bombay Register	1,40,00,000
Calcutta Register	1,40,00,000
Delhi Register	1,15,00,000
Madras Register	70,00,000
Rangoon Register	30,00,000

A provision is made that if at one centre like Delhi applications for shares for lesser value are received, they will be distributed to the other two, *viz.*, Bombay and Calcutta registers in equal proportion.

THE MANAGEMENT

The management of the Bank shall be under the supervision and control of (1) The central board of directors and (2) local boards.

The central board of management shall be made up of the governor and two deputy governors, four directors to be nominated by the Governor-General in Council, eight directors to be elected on behalf of the shareholders as two for Bombay, two for Calcutta, two for Delhi, one for Madras and one for Rangoon and in addition to this one Government official is to be the director as nominated by the Governor-General in Council. The governor and the deputy governors are full time officers.

The central board directors for each of the above areas are to be elected or selected by the directors of the local boards of each centre soon after the elections of the local board are complete, from among themselves, to represent the shareholders on the Register for the area for which these local boards are constituted, on the central board.

The local board is to be constituted of five members elected from among themselves by the shareholders who are

registered on the register for that area and qualified to vote and not more than three members nominated by the central board from among the shareholders register, on the register for that area, who may be nominated at any time. These local boards are to be constituted for each of the five areas as stated above, where separate registers are to be maintained. In connection with nominated directors on the local board, the central board is expected in the exercise of their power of nomination to aim at securing the representation of territorial or economic interests which are not already represented through the course of election, particularly the representation of agricultural interest and those of co-operation banks. As to the voting power it is provided that a shareholder who has been on the register for the area concerned for a period of not less than six months, ending with the date of the election, shall have one vote for every five shares subject to a maximum of ten votes. Thus voting power may be exercised either personally or by proxies appointed on each occasion, the proxy being always a brother shareholder entitled to vote at the election and should not be an employee of the bank. This particular clause thus discourages the use of proxies by bank officers at the time of similar elections, as in case of our joint stock banks. The local board will have the power to advise the central board on such matters as may be generally or specifically referred to it and to perform such duties as the central board may by regulations delegate to it.

DISQUALIFICATION OF A DIRECTOR

The Act lays down that the following shall not be members of a local board, *viz.*, (1) A salaried Government official or a salaried official of a ruling State in India. (2) A person adjudicated an insolvent or who has suspended payment or has compounded with his creditors, (3) a lunatic or a person of unsound mind, (4) an officer or employee of any bank and, (5) a director of any bank, except a bank which is a society registered or deemed to

be registered under the Co-operative Societies Act, 1912 or similar law as to Co-operative Societies in British India.

The directors as well as the Governor and Deputy Governors are removable from offices by the Governor-General in Council, except that in case of elected directors and the directors nominated, the power of removal can only be exercised on a resolution passed by the central board by a majority consisting of not less than nine directors. The share qualification of directors is the holding of unencumbered shares of the Reserve Bank of a nominal value of not less than Rs. 5,000. This qualification must be acquired at any time after six months from the date of his election or nomination, otherwise his place would be vacant. Even if he ceases to hold these shares at any time the result would be the same. He would be also disqualified in case he absents himself for three consecutive meetings of the central board without the consent of the Governor-General in Council. The same disqualification would apply to the members of the local boards. The directors of course can resign their offices, the difference being that the central board directors must address their resignation to the Governor-General in Council, whereas the local board offices may be resigned by a resignation addressed to the Central Board.

GENERAL MEETINGS

The general meeting of the shareholders is to be held annually at any of the offices of the bank within six weeks from the date on which the annual accounts of the bank are closed, provided that these meetings shall not be held consecutively on two occasions at any one place. The meetings, of course are to be convened by the central board. Here the shareholders are given power to discuss the annual accounts as well as the report of the central board and the auditors on the working of the bank and the annual balance sheet and accounts respectively. The voting power is the same as in case of election of directors, proxies being used on demand of a poll.

THE BUSINESS OF THE BANK

The business of the bank will be naturally divided into two separate compartments, one being that of note issue commonly known as "central banking functions" and the other is its banking business proper.

CENTRAL BANKING FUNCTIONS

In connection with central banking functions the most important naturally is the right to issue bank notes which is a monopoly right in the hands of the Reserve Bank. The Indian Government has naturally ceased to issue notes having transferred the whole function to this bank. The Issue Department functions as a separate and distinct department from the banking department as in case of the Bank of England and other similar banks and the assets of the issue department are not subject to any liability other than the liability of the Issue Department. The Issue Department liability will constitute a total amount made up of the currency notes of the Government of India and the bank notes for the time being in circulation. This is because on the date that Chapter Three of this Act came into force, the Issue Department of the Reserve Bank took over from the Indian Government the liability for all currency notes of the Government of India in circulation and in return the Government of India transferred to the Issue Department of the said bank gold coins, gold bullion, sterling securities, rupee coins and rupee securities to the aggregate value equal to the total of the liabilities transferred by the Indian Government in connection with its notes in circulation. The requirement is that, of the total amount of assets held as such security against notes, there shall be at least two-fifths of the total value made up of gold coins, gold bullions and sterling securities, and that, the amount of gold coins and gold bullion must not at any time be less than 40 crores of rupees in value. The remaining assets are to be held in rupee coins, Government of India rupee securities of any maturity and such bills of exchange

and promissory notes payable in British India as are eligible for purchase by the bank under the Act. Here the further provision is that the amount held in the Government of India rupee securities must not at any time exceed one-fourth of the total amount of the assets of 50 crores of rupees, whichever amount is greater or with the previous sanction of the Governor-General in Council such amount plus the sum of 10 crores of rupees. In connection with the valuation of these securities it is further provided that gold coins and gold bullion shall be valued at 8.47512 grains of fine gold per rupee, rupee coin shall be valued at its face value and the securities are to be valued at the market rate for the time being obtaining. Of this gold coin and gold bullions held as assets against note issue, not less than 17|20th shall be held in British India and such holding must be in the custody of the bank or its agencies. Details are given as to what form of sterling securities may be held as part of these assets against the note issue in the Act.

The Bank must issue rupee coins on demand in exchange for bank notes and currency notes of the Government of India and must issue currency notes or bank notes on demand in exchange for coins which are legal tender under the Indian Coinage Act, 1906.

Besides this, the much debated Sections 40 and 41 threw an obligation on the bank to purchase and sell sterling for immediate delivery in London at a ratio not below 1sh. 5d. and 49|64th of a penny for a rupee and 1sh. 6d. and 3|6th of a penny for a rupee, the only protection being that no person is entitled to demand to sell to the bank an amount of sterling less than £10,000|- and that no person shall be entitled to receive payment unless the bank is satisfied that the payment of the sterling in London has been made.

There are to be a number of banks in India which are given in Second Schedule to the Act, which are to be known as " Scheduled Banks," which banks must maintain with the reserve bank a balance which must not be less

at the close of any day than five per cent. of the "demand liabilities," and two per cent. of "time liabilities," of each of such bank in India. These liabilities for the purpose of calculation would not include the paid-up capital or reserves, or any credit balances in the profit and loss account of the bank, or the amount of any loan taken from the Reserve Bank. Managers of these Scheduled Banks have thus to send a return showing their position in connection with these liabilities at the close of business on each Friday and in case such Friday happens to be a public holiday under the Negotiable Instrument Act at the close of business on the preceding working day.

THE FUNCTION AS THE BANKER OF THE GOVERNMENT

The bank is given the privilege of acting as a banker of the Government and is to have under its exchange and management the provincial revenues on condition that may be agreed, together with all money remittances and exchange in banking transactions in India. All cash balances of the Government are to be in deposit free of interest with the bank. This is subject to the fact that where the bank has no branches or agencies, the Government is free to hold such balances, at such places as they may require. The design and form of notes must be according to the approval of the Government of India and as to the note issue, is to be the monopoly of the bank. No person other than the bank can in British India draw, accept, make or issue any bills of exchange, hundi, promissory note or engagement for payment of money payable to bearer on demand or borrow, owe or take up any sum or sums of money of bills, hundis, or notes payable to bearer on demand from any such person. From this regulation, cheques or drafts including hundis payable to bearer on demand and drawn on persons or against a banker, shroff or agent are excluded. Any violation of this rule is punishable with a fine.

BANKING BUSINESS OF THE RESERVE BANK

(1) The bank can receive money on deposit without interest from any person, bank, government, etc.

(2) It can discount or purchase bill of exchange and promissory notes drawn on and payable in India which arises out of *bona fide* commercial or trade transactions, the condition here being that they must bear at least two or more good signatures, one of which must be that of a Scheduled Bank, and that they must mature within 90 days from the date of purchase or re-discount exclusive of the days of grace.

(3) It can make similar purchase, sale and re-discount of bills of exchange and promissory notes under similar conditions bearing at least two good signatures of which one must be either of a scheduled bank or a provincial co-operative bank and which has been drawn or issued for the purpose of financing seasonal agricultural operations or marketing of crops and maturing within nine months from the date of purchase or re-discount exclusive of the days of grace. Similar purchase and re-discount of bills and promissory notes, with at least the signature of a scheduled bank under similar conditions, which are issued or drawn for holding or trading in securities of Governments of India, or a local Government, or that of States in India, as may be specified by the Indian Government on recommendation of central board, these bills to mature within 90 days from the days of purchase or re-discount excluding days of grace.

(4) It can purchase and sell to scheduled banks of sterling in amounts not less than Rs. 1,00,000.

(5) It can purchase and sell and re-discount of bills of exchange including treasury bills drawn in the United Kingdom maturing within 90 days from the date of purchase. Those transactions if made in India must be through a scheduled bank.

(6) It can keep balances with banks in the United Kingdom.

(7) It can make loans and advances either to States in

India and provincial co-operative banks against securities as laid down by the Act, *viz.*, the recognised Trust Securities for Investment by Trustees, Gold or Silver or documents of title of same, bills and promissory notes eligible for purchase by the bank, promissory notes of Scheduled banks, provincial co-operative banks which are supported by documents of title to goods and which were assigned or pledged to such banks as security for a cash credit or overdraft granted for *bona fide* commercial, or trade transaction or for the purpose of financing seasonal agricultural operations or marketing of crops.

(8) It can grant loans to Governor-General in Council and other Local Governments for the purpose of management of provincial revenues, etc.

(9) It can issue Bank Post Bills and demand drafts payable in their own offices.

(10) It can have dealings in purchase and sales of Government securities with certain reservations.

(11) It can take moneys, valuables and securities in safe custody.

(12) It can act as an agent for the Secretary of State, Governor-General in Council or the Local Government or of any State in India in connection with specific businesses such as purchase and sale of gold or silver, bills of exchange, securities, collection of proceeds whether principal, interest or dividends of securities or shares and remittances of same by Bills in India or elsewhere.

(13) It can manage public debt.

(14) It can deal in purchase and sale of gold coins and bullion on its own account.

(15) It can open an account with or make an agreement with any bank which is the principal currency authority of any country under the law for the time being in force in that country or any international bank formed by such banks. It may invest funds of the bank in the shares of any such international bank.

(16) It is allowed to borrow money for a period not exceeding one month for the purpose of its

business and may give security for such money. Here the loan must be taken either from one of the scheduled banks or from a bank outside India which is the principal currency authority of that country. The restriction here is that the total amount of such borrowings shall not in any case exceed the amount of the share capital of the bank.

(17) It can make and issue its own notes as authorised by the Act.

PROFITS AND ACCOUNTS OF THE BANK

It is here laid down that after providing from the profits of the bank, for all bad and doubtful debts and depreciation of assets and contributions to the staff and super-annuation funds, cumulative dividend not exceeding five per cent. per annum can be paid by the bank on the shares issued by it. As to an additional dividend over this maximum of five per cent. the Act had provided a gradation in Schedule IV according to the terms of which same may be paid. The balance after payment of such dividends is to be paid to the Government of India. It is further provided here that in case if at any time, the reserve fund of the bank is less than its share capital at least 50 lacs of rupees of which surplus which goes to the Government should be transferred to the Reserve Bank Fund and where the said surplus is less than 50 lacs, the whole of it will be transferred to the said fund. This means that the Act contemplates the creation of a reserve fund out of profits at least equivalent to its share capital and for that purpose the surplus which would otherwise go to the Government is to be taxed to the extent of at least 50 lacs of rupees annually until this objective is achieved. The bank is exempted from paying income-tax or super-tax on any of its incomes, profits or gains. The obligation is also thrown on the bank to publish from time to time its standard rate for purchasing or re-discounting bills of exchange or other commercial paper which it is authorised to deal in. The usual provisions as to auditors is also inserted who are not to be less

than two. Those auditors are to be elected at general meetings by the shareholders and as usual a director or officer of the bank is declared not eligible for this position, the first auditors being appointed by the central board. The Governor-General in Council, *i.e.*, the Government of India can appoint special auditors, if they so require, to examine and report upon the accounts of the bank. The duties of those auditors are more or less on the same footing as that of the joint stock company auditors and their powers are laid down on similar lines.

The bank has to publish weekly accounts of its issue department and banking department in a form set out in Schedule V on more or less the same basis as in the case of Bank of England.

AGRICULTURAL CREDIT DEPARTMENT

The bank has also to maintain an agricultural credit department where the expert staff has to study all questions of agricultural credit and will be available for consultation by the Government of India, Local Governments, provincial co-operative banks and other banking organisations. They are also expected to co-ordinate the operations of the bank in connection with agricultural credit and its relations with provincial co-operative banks and any other banks or organisations engaged in the business of agricultural credit.

EXTENSIONS OF THE ACT

A special section throws a duty on the bank to make a report at the earliest practicable date and in any case within three years from the date on which Chapter Four of the Act comes into force, to the Government of India embracing proposals if it thinks fit for legislation with a view to the extension of the provisions of the Reserve Bank Act as to the addition in the number of the Scheduled Banks of persons and banks not included in same and as to the improvement of the machinery for dealing with agricultural finance and matters affecting a closer connec-

tion between agricultural enterprise and the operations of the bank. The bank is also to report to the Government of India its views when it is of opinion that the international monetary position had become sufficiently clear and stable in order to make it possible to determine what will be suitable as a permanent basis for the Indian monetary system and to frame permanent measures for a monetary system. Thus a provision is clearly made for reports in the right direction for improvement and advancement in connection with this most important banking institution of our country.

The following is the Form in which the Reserve Bank of India issues its Balance Sheet divided into two compartments, viz., (1) for the Issue Department regarding its note issue and (2) for the Banking Department regarding its banking business

RESERVE BANK OF INDIA
STATEMENT OF AFFAIRS

The following is the account of the Reserve Bank of India for the week ended May 3, 1935.

Issue Department

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Notes held in the Banking Dept.	18,10,95,000		A. Gold Coin and Bullion :—		
Notes in circulation ..	1,67,55,86,000		(a) Held in India ..	41,55,15,000	
Total Notes issued		1,85,66,81,000	(b) Held outside India	2,86,98,000	
			Sterling Securities ..	48,62,95,000	
			Total of A		93,05,08,000
			B. Rupee Coin ..		49,56,54,000
			Government of India Rupee Securities ..		43,05,19,000
			Internal Bills of Exchange and other commercial Paper		Nil.
Total Liabilities ..		1,85,66,81,000	Total Assets ..		1,85,66,81,000

Ratio of total of A to Liabilities : 50·11 per cent.

The following is a statement of the affairs of the Reserve Bank of India, as on May 3, 1935.

BANKING DEPARTMENT

Liabilities	Rs.	Assets	Rs.
Capital paid-up	5,00,00,000	Notes	18,10,95,000
Reserve Fund	5,00,00,000	Rupee Coin	4,50,000
Deposits :—		Subsidiary Coin	1,94,000
(a) Government	17,03,40,000	Bills Discounted :	
(b) Banks	9,61,71,000	(a) Internal	Nil.
(c) Others	Nil.	(b) External	Nil.
Bills Payable	1,62,000	(c) Government of India Treasury Bills	Nil.
Other Liabilities	44,53,000	Balances held abroad (including cash and short-term securities)	13,70,63,000
		Loans and Advances to the Government	Nil.
		Other Loans and Advances	Nil.
		Investments	5,09,30,000
		Other Assets	13,94,000
Total	37,11,26,000	Total	37,11,26,000

THE IMPERIAL BANK OF INDIA

The Imperial Bank of India was founded in the year 1921 under a special Act of the Legislative Assembly called "The Imperial Bank of India Act of 1920." Since the formation of the Reserve Bank of India under the Reserve Bank of India Act of 1934, the Imperial Bank of India Act had to be amended in various particulars in the year 1934. The original Act of 1920 was passed with a view to amalgamate the three Presidency banks of Bombay, Bengal and Madras and bring into existence one Central Institution for India around which all the joint stock and other banks should cluster. In old days each Presidency had its separate Central Banking Institution, as India had not sufficiently developed in Inter-Provincial trade and Inter-Provincial finance, as the means of communication and transport were not as advanced as they had become at the date of passing of the Imperial Bank of India Act. By the year 1920 the country had sufficiently advanced to claim that one large bank for all India, instead of one in each of the Presidencies, should be established having branches all over the country and with principal offices at the three important centres of Bombay, Calcutta and Madras. The best method of bringing about such an institution was naturally the amalgamation of the three principal banks. This amalgamation had one other objective, *viz.*, the prevention of the amalgamated banking units of England from opening branches in this country and obtaining a footing which would be a menace to Indian banking.

India has been long burdened with a large number of outside banks, commanding a virtual monopoly of the exchange business, as well as controlling a large proportion of the deposit business of the country. As these banks have their head offices and board of directors located outside the country, it was increasingly felt that a powerful Indian bank under predominantly Indian directorate, with capital held by Indian shareholders, run in a large measure by Indian officers, was a necessity. This aspiration was sought to be answered by the amalgamation of the three presidency

banks into one gigantic unit in the year 1920 in the form of the Imperial Bank of India, controlling Indian commercial banking business all over the country through the help of a large number of branches at all important centres.

Though at the time the constitution was drafted on the footing of a joint stock bank, the objective was that the bank should occupy the important position of the banker of the Government of India and control as such the rates of interest on the money market. This function the old Imperial Bank performed to great satisfaction, but owing to the fact that it had not the control of the issue of currency and various other factors, it could not function satisfactorily as a central banking institution as it is expected to function under modern conditions. Thus when the Reserve Bank of India Act was passed with a view to provide for India a central bank in the real sense of the term, the Imperial Bank Act had to be amended in various particulars in the year 1934, the main object of amendment being to remove certain restrictions which had to be hitherto imposed as the bank had the monopoly of acting as the banker of the Government and handle the State money and public accounts. As these functions were transferred to the Reserve Bank on its inauguration, naturally many of these restrictions had to be removed, though it could not be placed on the same footing as an ordinary joint stock bank happens to be, because under the new arrangement, though the Imperial Bank ceases to be the Banker of the Government of India, it has been, by a special agreement between it and the Reserve Bank of India, appointed as the Sole Agent of the latter bank at all places in British India where the Imperial Bank had branches at the commencement of the Reserve Bank of India Act and where no branch of the Banking department of the Reserve Bank happens to be located. We shall deal with this agreement in detail a little later.

BANK'S CONSTITUTION

The capital of the three Presidency banks was made up of Rs. 3,75,00,000 in shares of Rs. 500 each fully

subscribed. The additional capital authorised was Rs. 7,50,00,000 also in shares of Rs. 500 each of which Rs. 125 has been called-up making in all the present capital of the Imperial Bank at Rs. 11,25,00,000 of which Rs. 5,62,50,000 has been paid-up. The Bank is authorised under the Act to have what are known as local head offices at Calcutta, Bombay and Madras. It has also a branch office in London which is now under the new Amended Act of 1934, permitted to open cash credits or keep cash accounts for or receive deposits from any person without restraint. Under the old Act it was not so but Section 9 of the old Act which placed a restraint in this direction has now been repealed. Further, the bank is allowed under agreement with the Reserve Bank of India to pay, receive, collect and remit money, bullion and securities as agent for the Reserve Bank of India on behalf of the Government and to undertake and transact any other business which the Reserve Bank of India may from time to time entrust to the bank. The old Act also made it compulsory for the bank to establish and maintain not less than 100 new branches of which at least one-fourth had to be established at places such as the Governor-General in Council may direct. This compulsion has now been removed and it is now left optional for the bank to maintain branches or agencies at its discretion at places where they were in existence in connection with Presidency banks or in other places where the bank deems advantageous for its own interest and the bank is also given the full liberty to discontinue any branch or agency if it so desires. The bank is also given the permission in Section 13 to enter into negotiations with the sanction of the Governor-General in Council, for purchase and taking over the business, including the capital assets and liabilities of any banking company carrying on business in India or elsewhere, of which the capital is divided into shares and may pay the consideration for such purchases either in cash, or by the allotment of shares in the capital of the bank, or partly in one and partly in other of these ways

and may (subject to the provisions of this Act relating to the increase of capital) for the purpose of any such allotment of shares, increase capital of the bank by the issue of such number of shares as may be determined on by the bank. Any business so purchased must after the purchase be carried on subject to the provisions of the Act. The bank may either alone, or co-jointly with other persons, for the purpose of averting the winding-up of any company having a share capital which is expressed in rupees in its memorandum of association or of any society registered under the Co-operative Societies Act of 1912, or any other law for the time being in force in British India relating to co-operative societies or where any such company or society is being wound-up, of facilitating the winding-up, advance or lend money to or upon a cash credit in favour of such company or society or the liquidators thereof, as the case may be, for any of such company or society. Thus the power of the Imperial Bank to come in and help a company which has come into financial difficulties in various ways if it so desires and as it has done on previous occasions to great public advantage, has been maintained in tact and unaffected.

BOARDS OF MANAGEMENT

The control of the bank is vested into two boards of management (1) the central board and (2) the local board. The general superintendence of the affairs and business of the bank is entrusted to a central board of directors, who are authorised to exercise all powers and do all such acts and things as may be exercised or done by the bank and are not expressly directed or required by this Act to be done by the bank in general meeting. The local board are to be established at Calcutta, Madras and Bombay and at such other places in British India as the central board may determine. The sanction of the Governor-General in Council in this connection which was compulsory under the old Act is now not necessary. The other alternative is that instead of being called Governors,

the members of both the central and local boards will now be known as directors.

CONSTITUTION OF CENTRAL BOARD AND POWERS TO MAKE BYE-LAWS

Sec. 26. (1). The Central Board shall consist of the following Directors, namely :—

(*i*) the presidents and vice-presidents of the Local Boards established by this Act;

(*ii*) one person to be elected from amongst themselves by the members of each Local Board established by this Act;

(*iii*) a Managing Director who shall be appointed by the Central Board for a period not exceeding five years on such terms as the Central Board may direct, and may be continued in his appointment by the Central Board for such further periods not exceeding five years in each case as the Central Board thinks fit;

(*iv*) such number of persons not exceeding two and not being officers of the Government as may be nominated by the Governor-General in Council. Such persons shall hold office for one year but may be re-nominated;

(*v*) a Deputy Managing Director who shall be appointed by the Central Board;

(*vi*) the secretaries of the Local Boards established by this Act; and

(*vii*) if any Local Board is hereafter established under this Act, such number of persons to represent it as the Central Board may prescribe;

(2) The Directors specified in clauses (v) and (vi) of sub-section (1) shall be at liberty to attend all meetings of the Central Board and to take part in its deliberations, but shall not be entitled to vote on any question arising at any meeting;

Provided that the Deputy Managing Director shall be entitled to vote in the absence of the Managing Director.

(3) The Governor-General in Council shall nominate an officer of Government to attend the meetings of the Central Board, and such officer shall be entitled to attend all meetings of the Central Board and to take part in its deliberations but shall not be entitled to vote on any question arising at any meeting.

The Central Board has the power to make bye-laws, with the previous approval of the Governor-General in Council consistent with the Act on the following matters under Section 31 :—

(*a*) the maximum amounts which may be advanced, or lent

to or for which bills may be discounted for any individual or partnership, without the security mentioned in sub-clauses (*i*) to (*iv*) of clause (*a*) of Part I of Schedule I, the conditions under which advances may be made on the said security and the extent of the sums to which accounts may be overdrawn without security.

NOTE :—The above sub-clauses refer to the authority of the bank to lend money or open cash credits on the security of stocks, and securities other than immovable property in which a trustee is authorised to invest, securities issued by state-aided railways, debentures or other securities for money issued under the Authority of a legislature in British India or a District Board or Municipal Board or Committee or with the sanction of Governor-General in Council or debentures and other similar securities issued under the authority of a Prince or Chief of any state in India; the debentures of companies witn limited liabilities as directed by the Central Board and goods or documents of title to goods either deposited with or assigned to the bank or hypothecated to it as securities for such advances.

(*b*) the conditions subject to which alone advances may be made to Directors, members of Local Boards, or officers of the Bank, or the relatives of such Directors, members or officers or to companies, firms, or individuals with which or with whom such directors, members, officers or relatives are connected as partners, directors, managers, servants, shareholders, or otherwise :—

Provided that the bye-laws shall provide that no advance without security shall be made to any officer of the Bank without the specific sanction of the Local Board under which he is serving :

(*c*) the particulars to be contained in the annual and half-yearly balance sheets, and

(*d*) any matter which by this Act is directed to be prescribed.

The Central Board may, with the previous approval of the Governor-General in Council, make bye-laws consistent with this Act regulating the following matters or any of them namely :—

(*e*) the keeping of the register and branch registers of shareholders;

(*f*) the distribution of business amongst the Directors and their remuneration, if any;

(*g*) the distribution of business among the members of a Local Board and their remuneration, if any;

(*h*) the delegation of any powers of the Central Board or of

a Local Board to committees consisting of Directors or members, as the case may be;

(*i*) the procedure to be followed at the meetings of the Central or Local Boards or of any committees thereof;

(*j*) the first appointment and the appointment of members of a Local Board established under this Act;

(*k*) the powers of Local Boards established by or under this Act;

(*l*) the localities in, and with respect to which such Local Boards shall exercise their powers;

(*m*) the books and accounts to be kept at the Local head offices of the Bank;

(*n*) the renewal of certificates of shares which have been worn out or lost;

(*o*) the conduct and defence of legal proceedings and the manner of signing pleadings;

(*p*) the constitutions and management of pension and provident funds for the officers and servants of the Bank;

(*q*) all matters which are by this Act permitted to be prescribed; and

(*r*) generally, the conduct of the business of the Bank.

LOCAL BOARDS

As we have seen under Section 25, local boards are allowed to be established at Calcutta, Madras and Bombay and at such other places in British India as the central board may deem necessary. These local boards are to have power generally to transact all the usual business of the bank without prejudice to the powers reserved to the central bank and shall also have power as regards entries in the branch register kept at these places where the boards are situated and to examine and pass or refuse to pass, transfer and transmissions, and to approve or refuse to approved transferees of shares and to give certificates of shares (Sec. 26).

COMMERCIAL BUSINESS OF THE BANK

Business Authorised

Under the new Amended Act of 1934, the bank's scope of doing business has been enlarged than was the case under the original act. The type of business which

is now permitted to be done by the Imperial Bank under Schedule I Part I is the following :

(*a*) the advancing and lending money, and opening cash credits upon the security of :—

(*i*) stocks, funds and securities (other than immovable property) in which a trustee is authorized to invest trust money by any Act of Parliament or by any Act of the Governor-General in Council, any securities of a Local Government or the Government of Ceylon and shares of the Reserve Bank of India;

(*ii*) such securities issued by State-aided railways as have been notified by the Governor-General in Council under Section 36 of the Presidency Banks Act, 1876 or may be notified by him under this Act in that behalf;

(*iii*) debentures or other securities for money issued under the authority of any Act of a legislature established in British India by, or on behalf of, a District Board or a Municipal Board or committee or, with the sanction of the Governor-General in Council, debentures or other securities for money issued under the authority of a Prince or Chief of any State in India;

(*iiia*) subject to such directions as may be issued by the Central Board, debentures of companies with limited liability whether registered in India or elsewhere;

(*iv*) goods which, or the documents of title to which, are deposited with, or assigned to, the Bank as security for such advances, loans or credits;

(*iva*) goods which are hypothecated to the Bank as security for such advances, loans or credits, if so authorised by special directions of the Central Board;

(*v*) accepted bills of exchange and promissory notes endorsed by the payees and joint and several promissory notes of two or more persons or firms unconnected with each other in general partnership; and

(*vi*) fully paid shares of companies with limited liability, or immovable property or documents of title relating thereto as collateral security only where the original security is one of those specified in sub-clauses (*i*) to (*iv*), and subject to

such directions as may be issued by the Central Board where the original security is of the kind specified in sub-clause (*v*);

Provided that such advances and loans may be made, if the Central Board think fit, to the Secretary of State for India in Council, without any specific security;

(*b*) the selling and realisation of the proceeds of sale of any such promissory note, debentures, stock-receipts, bonds, annuities, stock-shares, securities or goods which or the documents of title to which have been deposited with or pledged, hypothecated, assigned or transferred to the bank as security for such advances, loans or credits, or which are held by the Bank or over which the Bank is entitled to any lien or charge in respect of any such loan or advance or credit or any debt or claim of the Bank and which have not been redeemed in due time in accordance with the terms and conditions (if any) of such deposit pledge, hypothecation, assignment or transfer;

(*c*) the advancing and lending money to Courts of Wards upon the security of estate in their charges or under their superintendence, and the realisation of such advances or loans and any interest due thereof, provided that no such advance or loan shall be made without the previous sanction of the Local Government concerned, and that the period for which any such advance or loan is made shall not exceed nine months in the case of advances or loans relating to the financing of seasonal agricultural operations or six months in other cases;

(*d*) the drawing, accepting, discounting, buying and selling of bills of exchange and other negotiable securities;

(*e*) the investing of the funds of the Bank upon any of the securities specified in sub-clauses (*i*) to (*iii*) of clause (*a*) and converting the same into money when required, and altering, converting and transposing such investments for or into others of the investments above specified;

(*f*) the making, issuing and circulating of bank-post-bills and letters of credit to order, or otherwise than the bearer on demand;

(*g*) the buying and selling of gold and silver whether coined or uncoined;

(*h*) the receiving of deposits and keeping cash accounts on such terms as may be agreed on;

(*i*) the acceptance of the charge of plate, jewels, title-deeds or other valuable goods on such terms as may be agreed on;

(*j*) the selling and realising of all property whether moveable or immoveable, which may in any way come into the possession of the bank, in satisfaction or part satisfaction of any of its claims and acquisition and holding of, and generally the dealing with, any right, title or interest in any property, moveable or immoveable, which may be the Bank's security for any loan or advance or may be connected with any such security;

(*k*) the transacting of pecuniary agency business on commission; and the entering into of contracts of indemnity, suretyship or guarantee with specific security or otherwise;

(*l*) the administration of estates for any purpose whether as an executor, trustee or otherwise and the acting as agent on commission in the transaction of the following kinds of business, namely :

  (*i*) the buying, selling, transferring and taking charge of any securities or any shares in any public company;

  (*ii*) the receiving of the proceeds, whether principal, interest or dividends, of any securities or share;

  (*iii*) the remittance of such proceeds by public or private bills of exchange, payable either in India or elsewhere.

(*m*) the drawing of bills of exchange and the granting of letters of credit payable out of India.

(*n*) the buying of bills of exchange payable out of India, at any usance not exceeding nine months in the case of bills relating to the financing of seasonal agricultural operations or six months in other cases;

(*o*) the borrowing of money for the purposes of the Bank's business and the giving of security for money so borrowed by pledging assets or otherwise;

(*p*) the subsidizing from time to time of the pension funds of the Presidency Banks; and

(*q*) generally the doing of all such matters and things as may be incidental or subsidiary to the transaction of the various kinds of business including foreign exchange business hereinbefore specified.

The relaxation of old restrictions in connection with the business that the Imperial Bank can do, is due to the

fact that it is no longer now the banker of the Government, though it does act as the agent of the Reserve Bank of India and as such indirectly looks after the business of the Government in connection with its financial operations in places where the Reserve Bank of India has not its own offices.

However, as a certain amount of State business has to be done by the Imperial Bank, it has been restrained in a few particulars with a view to secure safety of the State money, though not to the extent it originally was. It is thus free to lend money on debentures of companies with limited liability whether registered in India or elsewhere or on goods which are hypothecated to it as security for advance and not exclusively on goods or documents of title deposited with it as was the case formerly. In connection with transactions in discounting of bills it is now entirely free and unfettered to advance or lend money on bills of exchange and other negotiable securities, bank post-bills and letters of credit to order or otherwise than to the bearer on demand, or to draw, buy or sell same anywhere in the world, instead of being restricted as before in connection with these operations to India and Ceylon. It is further given the power in addition to that of selling and realising of immoveable property which came into its possession in satisfaction or part satisfaction of its claims, to acquire and hold same and generally to deal with the same if the bank has acquired it as security for any loan or advance. The bank is further empowered to enter into contracts of indemnity, suretyship or guarantee or specific securities or otherwise, which it did not possess before. The bank is further given the most important power of doing business in foreign exchange which it did not possess before.

Business Prohibited

The bank is not authorised to carry on the following business according to Part II of Schedule I :—

1. It shall not make any loan or advance :

(*a*) for a longer period than six months, except as provided in clause (*c*) and clause (*n*) of Part I, or

(*b*) upon the security of stock or shares of the Bank, or

(*c*) save in the case of the estates specified in clause (*e*) of Part I, upon mortgage or in any other manner upon the security of any immoveable property, or the documents of title relating thereto.

2. The Bank shall not (except upon a security of the kind specified in sub-clauses (*i*) to (*iv* of clause (*a*) of Part I) discount bills for any individual or partnership firm for an amount exceeding in the whole at any one time such sum as may be prescribed or lend or advance in any way to any individual or partnership firm an amount exceeding in the whole at any one time such sums as may be so prescribed.

3. The Bank shall not discount or buy, or advance and lend, or open cash credits on the security of any negotiable instrument of any individual or partnership firm, payable in the town or at the place where it is presented for discount, which does not carry on it the several responsibilities of at least two persons or firms unconnected with each other in general partnership.

4. The Bank shall not discount or buy, or advance and lend, or open cash-credits on the security of any negotiable security (not being a security in which a trustee may invest trust money under Section 20 of the Indian Trusts Act, 1882) having at the date of the proposed transaction, a longer period to run than nine-months if a bill drawn for the purpose of financing seasonal agricultural operations and six months in other cases, or if drawn after sight, drawn for a longer period than nine months if a bill drawn for the purpose of financing seasonal agricultural operations and six months in other cases.

Provided that nothing in this part shall be deemed to prevent the bank from allowing any person who keeps an account with the bank to overdraw such account, without or with security, to such extent as may be prescribed.

BALANCE SHEETS

The balance sheets of the Imperial Bank of India and the Reserve Bank of India respectively appeared as follows immediately after the last named bank began to function and the transfer of the Government accounts was duly effected :—

IMPERIAL BANK STATISTICS

The following is the Imperial Bank return for the week-ended April 5, 1935 :

Liabilities	Rs.	Assets	Rs.
Subscribed capital	11,25,00,000	Government securities	42,02,49,000
Capital Paid-up	5,62,50,000	Other authorised securities for the Act	9,28,000
Reserve Fund	5,35,00,000	Loans	8,65,54,000
Fixed Deposits, Savings Bank, Current and other Accounts	74,82,28,000	Cash credits	20,15,44,000
Loans against securities per contra	Nil	Bills discounted and Purchased	3,54,77,000
Acceptances for Constituents	Nil	Liabilities of Constituents for Acceptances per Contra	Nil
Sundries	67,71,000	Dead stock	2,39,51,000
		Sundries	57,13,000
		Bullion	Nil
		Balances with other Banks	10,59,000
		Cash in hand with the Reserve Bank of India	8,92,74,000
Total Rs.	86,47,49,000	Total Rs.	86,47,49,000

RESERVE BANK OF INDIA

The following is a statement of the affairs of the Issue and Banking Departments of the Reserve Bank of India for the week-ended April 5, 1935 :—

ISSUE DEPARTMENT

Liabilities	Rs.	Assets	Rs.
Notes held in the Banking Department	19,05,29,000	A. Gold Coin and Bullion :	
		(a) Held in India	41,55,19,000
Notes in Circulation	1,66,99,97,000	(b) Held outside India	2,86,98,000
Total Notes Issues	1,86,05,26,000	Sterling Securities	48,62,95,000
		Total of Act	93,05,12,000
		B. Rupee Coin	49,94,95,000
		Government of India Securities	43,05,19,000
		Internal Bills of Exchange and other commercial Paper	..
Total Notes Issued Rs.	1,86,05,26,000	Total Assets Rs.	1,86,05,26,000

Ratio of Total of A to Liabilities : 50.013 per cent.

BANKING DEPARTMENT

Liabilities	Rs.	Assets	Rs.
Capital Paid-up	5,00,00,000	Notes	19,05,29,000
Reserve Fund	5,00,00,000	Rupee Coin	3,30,000
Deposits :		Subsidiary Coin	1,04,000
(*a*) Government	18,36,41,000	Bills Discounted :	
(*b*) Banks	7,82,07,000	(*a*) Internal	Nil.
(*c*) Others	Nil.	(*b*) External	Nil.
Bills Payable	43,000	(*c*) Government of India Treasury Bills	Nil.
Other Liabilities	1,85,000	Balances held abroad*	11,94,95,000
		Loans and Advances to the Government	..
		Other Loans and Advances Investments	5,00,00,000
		Other Assets	16,18,000
Rs.	36,20,76,000	Rs.	36,20,76,000

NOTE 1 :—For the present, the figure shown under Banks' Deposits represents the balance deposited by the Imperial Bank of India.

2 :—The increase in the Government balance as compared with that shown by the statements previously published by the Imperial Bank is due to the fact that the balance now includes a credit on account of sterling assets of Government transferred to the Banking Department.

---

* Includes Cash and Short Term Securities.

CURRENCY STATISTICS OF GOVERNMENT

Immediately Prior to Transfer

The following is the abstract of the accounts of the Currency Department on 31st March, 1935 :—

	Rs.
Notes in Circulation	1,86,10,25,276
Reserve—Coin and Bullion India :—	
Silver Coin	77,25,30,254
Gold Bullion	41,55,19,103
Silver Bullion	13,12,47,327
In England	..
In His Majesty's Dominions	..
In transit between England, India and His Majesty's Dominions	..
Total Coin and Bullion Rs.	1,31,92,96,684
Securities (purchase price) :—	
In India of the nominal value of Rs. 36,07,00,000	35,89,71,125
In England of the nominal value of £13,715,000 ..	18,27,55,467
Total Securities Rs.	1,86,10,23,276
Internal Bills of Exchange held on account of Government under Sec. 20 of the Indian Paper Currency Act, 1923	..
Percentage of metallic reserve to circulation ..	70.89

THE GOLD STANDARD RESERVE

The balance of the Gold Standard Reserve on the 29th February, 1935, amounted to £40,000,000 and was held in the following form :—

	£
1. Cash at short notice at the Bank of England ..	3,075
2. British Treasury Bills	11,618,280
3. Other British and Dominion Govt. Securities ..	26,226,311
4. Gold in England	2,152,334
Total £	40,000,000

Balance Sheet of the Imperial Bank as it was immediately prior to the transfer of Government Accounts.

IMPERIAL BANK

Statistics

The following is the Imperial Bank return for the week-ended March 29, 1935 :—

LIABILITIES	Rs.	ASSETS	Rs.
Subscribed Capital	11,25,00,000	Government Securities	43,80,92,000
Capital Paid-up	5,62,50,000	Other Authorised Securities under the Act	9,28,000
Reserve	5,35,00,000	Ways and Means advances to the Government of India	..
Public deposit	10,89,98,000	Loans	8,87,92,000
Other deposits	80,69,12,000	Cash Credits	20,93,30,000
Loans from the Government of India under Section 20 of the Paper Currency Act against Inland Bills, discounted and purchased per contra	..	Inland Bills discounted and purchased	3,33,94.000
Contingent Liabilities	..	Foreign Bills discounted and purchased	30,76,000
Sundries	1,16,78,000	Bullion	..
		Dead stock	2,46,77,000
		Liability of Constituents for Contingent Liabilities per contra	..
		Sundries	42,81,000
		Balances with other cash	23,40,86,000
Total Rs.	1,03,73,38,000	Total Rs.	1,03,73,38,000

CHAPTER XVI

Accounts, Profits, Reserves and Dividends

The Companies Act lays down that *every company shall cause to be kept proper books of account with respect to (1) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place, (2) all sales and purchases of goods by the company, (3) the assets and liabilities of the company. The books of account must be kept at the registered office of the company or at such other place as the directors think fit, and shall open to inspection by the directors during business hours. In the case of a company managed by a managing agent, or where the managing agent is a firm or company, the partner or director of such firm or company and in any other case the director or directors who have knowingly by their act or omission been the cause of any default by the company in complying with these requirements are liable in respect of such offence to a fine not exceeding rupees one thousand (Sec. 130). It will here be noticed that where the managing agents are in management of the company the law makes them solely responsible for seeing these requirements being complied with and the directors are made responsible only in cases of companies worked without managing agents. The directors of every company must at some date not later than eighteen months after the incorporation of the company and subsequently once at least in every calendar year lay before the company in general meeting a balance-sheet and profit and loss account or in the case of a company not trading for profit an income and expenditure account for the period. This account has to be prepared in the case of the first account since the incorporation of the company and in any other case since the preceding account made upto a date not earlier than*

the date of the meeting by more than nine months or in the case of a company carrying on business or having interests outside British India by more than twelve months. However the registrar may for any special reason extend the period by a period not exceeding three months [*Sec. 131 (1)*]. Thus it will be seen that now a limit is laid down beyond which accounts cannot be allowed to fall in arrear as was the case in some Indian companies against which there was much agitation from the shareholders and investors. *The balance-sheet and the profit and loss account or income and expenditure account shall be audited by the auditor of the company as provided by the Act and the auditors' report must be attached thereto or there must be inserted at the foot thereof a reference to the report. This report must be read before the company in general meeting and shall be open to inspection by any member of the company* [*Sec. 131 (2)*]. *A copy of this balance-sheet and profit and loss account or income and expenditure so audited, together with a copy of the auditors' report must be sent to the registered address of every member of the company at least fourteen days before the meeting at which it is to be laid before the members of the company. A copy of these must also be deposited at the registered office of the company for the inspection of the members of the company during a period of at least fourteen days before that meeting* [*Sec. 131 (3)*]. *This compulsory circulation of a profit and loss account or income and expenditure account has now been introduced and made compulsory under the Amendment Act of 1936, which prior to that was optional. The last requirement of sending a copy of the accounts and the balance-sheet do not apply to a private company. Besides the above, the directors must now make out and attach to every balance-sheet a report with respect to the state of the company's affairs, the amount, if any, which they recommend should be paid by way of dividend and the amount, if any, which they propose to carry to the reserve fund, general reserve or reserve account shown specifically on the balance-sheet*

or to a reserve fund, general reserve or reserve account to be shown specifically in a subsequent balance-sheet [Sec. 131A (1)]. The report may be signed by the chairman of the directors on behalf of the directors if authorised by them [Sec. 131A (2)]. The provisions of Sec. 130 (3) shall apply to any person being a director who is knowingly and wilfully guilty of a default in complying with the Sec. 131A. The Act expects the balance-sheet to contain a summary of the property, assets and liabilities of the company, giving such particulars as will disclose the general nature of the said liabilities and assets, together with a statement as to how the value of the fixed assets has been arrived at. The form in which the balance-sheet has to be made out is indicated by the Act in a form marked " F " in its third schedule. *The profit and loss account include particulars showing the total of the amount paid whether as fees, percentages or otherwise to the managing agents, if any, and the directors respectively as remuneration for their services and, where a special resolution passed by the members of the company so requires, to the manager, and the total of the amount written off for depreciation. If any director of the company is by virtue of the nomination, whether direct or indirect, of the company, a director of any other company, any remuneration or other emoluments received by him for his own use, whether as a director of, or otherwise in connection with the management, that other company, must be shown in a note at the foot of the account or in a statement attached thereto (Sec. 132).* The balance-sheet, *and profit and loss account or income and expenditure account* in case of a banking company must be signed by the manager or *managing agent* (if any) and where there are more than three directors of the company, by at least three of these directors and when there are not more than three directors by all the directors. In case of any other company it must be signed by two directors or when there are less than two directors by the sole director and by the manager or *the managing agent* (if any) of the company [Sec. 133 (1)].

When the total number of directors of the company for the time being in British India is less than the number of directors whose signatures are required as above, the balance-sheet and *profit and loss account or income and expenditure account* shall be signed by all the directors for the time being in British India or if there is only one director for the time being in British India by such director, but in such a case there shall be sub-joined to the balance-sheet and *profit and loss account or income and expenditure account* a statement signed by such directors or director explaining the reason for non-compliance with the above provision [Sec. 133 (2)]. *In case there is any default in laying before the company or in issuing a balance-sheet and profit and loss account or income and expenditure account as required by Sec. 131 or if any balance-sheet or profit and loss account or income and expenditure account is issued, circulated or published which does not comply with the requirements laid down by and under Secs. 131, 132, 132A and 133 the company and every officer of the company who is knowingly and wilfully a party to the default shall be punishable with fine which may extend to five hundred rupees.* These balance-sheets, *and profit and loss account* in case of public companies, have to be filed with the registrar of joint stock companies after they are laid before the general meeting, within seven days of the said meeting. In case the general meeting before which the said balance-sheet is laid does not adopt it, that fact and the reason for such non-adoption must also be annexed to the balance-sheet filed with the registrar (Sec. 134). Besides this, in case of limited banking companies or insurance companies, or a deposit, provident or benefit society, shall before the commencement of the business and also on the first Monday in February, and the first Monday in August during every year, in which business is carried on make a statement in the form marked "G" in the third schedule, or as near thereto as circumstances will admit. A copy of this statement *together with a*

copy of the last audited balance-sheet laid before the members of the company, has to be displayed in the registered office of the company in a conspicuous place, as well as in branch offices, or places where the business of the company is carried on, until the display of the next statement. Every creditor or member of the company shall be entitled to get a copy of this statement on payment of a small fee not exceeding eight annas. Non-compliance entails a fine of fifty rupees for every day on the company and every officer of the company, knowingly and wilfully permitting same. This requirement will not apply to those life insurance or provident insurance societies to which the provisions of the Indian Life Assurance Companies Act of 1912, or of the Provident Insurance Societies Act of 1912 apply. The Table "A," as we have seen, provides for the inspection of books of accounts by members, but the right of determination as to the time, the extent and conditions under which they shall be so open is left to the directors (Cl. 105). This is reasonable because it is impossible as well as undesirable, to reserve unlimited powers to ordinary members of the company in this regard. Of course, the register of members, as well as that of mortgages, are open to their inspection according to the provisions of Secs. 36 and 124, respectively. This right does not include that of an access to the minute books in which the minutes of the proceedings of directors' board meetings are recorded. The members are also entitled to get a copy of either the register of members, or of the register of mortgages on payment of a small fee.

It should however be noted that a shareholder under the Companies Act itself has no right of inspecting the company's books of account himself, unless the articles give him such right. Table "A," Clause 105, suggests a right which may be given by the articles and which runs as follows :—

"The directors shall from time to time determine whether and to what extent and at what times and places and under what con-

ditions or regulations the accounts and books of the company or any of them shall be open to the inspection of members not being directors, and no member, (not being a director) shall have any right of inspecting any account or book or document of the company except as conferred by law or authorised by the directors or by the company in General Meeting.

The Indian articles used on this point are usually framed on the following construction :—

"The managing agents under the control of directors shall from time to time determine whether and to what extent and at what times and places and under what conditions or regulations, the accounts and books of the company or any of them shall be open to the inspection of members (not being directors) and no member (not being a director) shall have any right of inspecting any account or book or document of the company except as conferred by statute or authorised by the directors or by a resolution of the company in General Meeting."

Under the common law however a shareholder's right is restricted to a definite right or object of his own (*Bank of Bombay* v. *Sulaiman Somji*, (1908) 32 *Bom.* 466). However, where a member is given the right to inspect accounts by the articles, he may get same done by a skilled agent, such as an accountant, provided that the agent is not objectionable to the company on personal grounds and that he gives an undertaking not to disclose the information he gets through such inspection to anyone but his own client or principal (*Dodd* v. *Amalgamated Marine Workers Union,* (1924) 1 *Ch.* 116). If, however, a winding-up has commenced, the inspection can be only obtained by an order of the Court under Sec. 241. Of course director can inspect the books and documents of the company at any time (*Burn* v. *London and South Wales Coal Co.*, (1890) 7 *T. L. R.* 118).

BOOKS OF ACCOUNT

In case of joint stock companies, all the books of account required may be divided into two headings, *viz.*, (1) Statutory books, *i.e.*, those compulsory under the Indian Companies Act, (2) The optional books, and what

are known as (3) the financial set of books. The statutory books are the following :—

(1) register of members (Sec. 31), (2) register of directors (Sec. 87), (3) register of mortgages and charges (Sec. 123), (4) minute books of directors' and shareholders' meeting (Sec. 83), (5) return of annual list of members and summary of capital book (Sec. 32 (3)).

The optional books that a joint stock company may keep may vary from one company to another according to circumstances of each case, nature of business and the demands on the system of accountancy prevailing in the company concerned.

(2) The optional books are the following :—(1) Application and allotment book, (2) call book, (3) share certificate book, (4) register of transfers, (5) debenture interest book, (6) dividend book, (7) seal register, (8) register of probates, (9) directors' attendance book, (10) agenda book, (11) register of debenture holders.

(3) The financial set of books are books that must be maintained to record business transactions of receipts and payments, purchases and sales, profits and losses made by the company and the assets, liabilities and reserves of the company.

The articles with regard to books of accounts in connection with Indian companies are more or less in the following form :

A Specimen Article Referring to Books of Accounts

"The managing agents shall cause *proper books of* accounts to be kept of the paid-up capital for the time being of the company, and of all sums of money received or expended by the company, and of the matters in respect of which such receipt or expenditure takes place *all sales* and purchases of *goods* by *the company* and of the *assets* and liabilities of the company, and generally of all its commercial, financial, and other affairs, transactions, and engagements, and of all other matters necessary for showing the true financial state and condition of the company, and the accounts shall be kept in such books and in such manner as the directors may deem expedient. *The books of account shall be kept at the registered office of the company or at such other place as the*

directors think fit and shall be open to inspection by the directors during business hours.

Holding (Parent) Companies and Subsidiaries

A very recent and interesting feature of the development of company system in England and America as well as in this country is the advent of holding or parent companies with their subsidiaries. The system, though of recent growth, has rapidly developed. Under the system, the holding company acquires a sufficient number of shares in other companies called the subsidiaries with a view to exercise a controlling interest in the affairs of the subsidiaries. The result is that, though the parent company and each of its subsidiary remains so many separate entities in law, the whole organization, in practice in most cases, is working under the central policy as determined by the management of the parent or holding company. These companies no doubt can be and are worked with great advantage if properly directed. In cases where (1) a parent (holding) company wishes one or more of its department of business to be separated into so many subsidiary companies thereby creating a separate goodwill or (2) to purchase a business similar to its own and work same separately with a view to get rid of adverse competition or (3) to obtain a controlling interest in other concerns by purchasing their shares and using them as agencies, etc., or (4) wishes to invest capital in profitable enterprises or (5) wishes to open out branches at different locations in the form of independent entities and thus form separate companies for each location, such as, the Bombay Trading Co., may start a branch office in East Africa and call it The Bombay Trading Co. (East Africa) Ltd., and incorporate same in East Africa according to the Companies Act of that place and so on. The weakness of this advantageous system lies in the power which the directors or managing agents of companies acquire by which they are, if so inclined, in a position to mislead the shareholders and manipulate any subsidiary

company with disadvantage to the shareholders of the parent company. This manipulation generally takes the form of entering into inter-company transactions with the predominant idea of concealing from the public and shareholders of the parent company certain transactions or the true state of affairs or with the idea of so manipulating as to increase the profits of the company ficticiously on which the management by way of remuneration as commission may depend by transferring or pretending to sell to a subsidiary one or more of the least paying departments so that the losses caused by such departments may become the losses of the subsidiary with corresponding artificial increase in the profit of the parent company. The English Act of 1929 tackled this question on the recommendations of the Greene Commission of 1925-26 by providing for accounts of holding companies being prepared in a particular manner. Our Indian Companies (Amendment) Act 1936, has taken up this question in a greater detail and has gone further even from the English enactment taking advantage of the experience of the working of the subsidiaries and holding companies both in England and in India since the time when the Greene Commission Report was written.

Definition of Holding Company

Where the assets of a company consist in whole or in part of shares in another company, whether held directly or through a nominee and whether that other company is a company within the meaning of this Act or not and the amount of shares so held is, at the time when the accounts of the holding company are made up, more than fifty per cent. of the voting power in that other company, or the company has power (not being power vested in it by virtue only of the provisions of a debenture trust deed or by virtue of shares issued to it for the purpose in pursuance of those provisions) directly or indirectly to appoint a majority of the directors of that other company, that the other company shall be deemed to be a subsidiary company

within the meaning of the Act. The expression subsidiary company in the case of which the conditions are satisfied and includes a subsidiary of such company. However, where a company whose business includes the lending of money holds shares in another company as security only, no account, shall, for the purpose of determining under this section whether that company is a subsidiary company, be taken of the shares so held (Section 2, sub-section 2).

Balance Sheet of Parent Companies

When a holding company holds shares either directly or through a nominee in a subsidiary company or in two or more subsidiary companies, to the balance sheet of the holding company shall be annexed the last dated balance sheet, profit and loss account and auditors' report of the subsidiary company or companies, and a statement signed by the persons by whom, in pursuance of Section 133, the balance sheet of the holding company has been signed stating how the profits and losses of the subsidiary company, or where there are two or more subsidiary companies, the aggregate profits and losses of those *companies have been dealt with for the purpose of the accounts of the holding company. It should be particularly shown how and to what extent (1) provision has been made for the loss of a subsidiary company or of the holding company or of both, and (2) losses of the subsidiary company have been taken into account by the directors of the holding company in arriving at the profits and losses of the company as disclosed in its accounts. However, it shall not be necessary to specify in any such statement the actual amount of the profits or losses of any subsidiary company or the actual amount of any part of any such profits or losses which has been dealt with in any particular manner. An investment company, i.e., a company whose principal business is acquisition and holding of shares, stocks, debentures or other securities shall not be deemed to be a holding company, simply because part of its assets consists in fifty-one per cent. or more of the assets of another*

company (Section 132A sub-section 1). In case where the auditors' report of a subsidiary company on the balance-sheet of the company does not state without qualifications that the auditors have obtained all the information and explanation they have required and that the balance-sheet is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of their formation and the explanation given to them and as shown by the books of the company, the statement, which is to be annexed as aforesaind to the balance-sheet of the holding company shall contain particulars of the manner in which the report is qualified (Section 132 sub-section 2).

For the above purposes, the profits or losses of a subsidiary company mean the profits or losses shown in any accounts of the subsidiary company made up to a date within the period to which the accounts of the holding company relate, or if there are no such accounts of such subsidiary company available at the time when the accounts of the holding company are made up, the profits and losses shown in the last previous accounts of the subsidiary company which became available within that period (Section 132A sub-section 3).

It is further provided that where for any reason the directors of the holding company are unable to obtain such information as is necessary for the preparation of the statement required as above, the directors who signed the balance-sheet shall so report in writing and the report shall be annexed to the balance-sheet in lieu of the statement (Section 132A sub-section 4).

The holding company may by a resolution authorise its representatives named in the resolution to inspect the books of accounts kept in accordance with Section 130 by any subsidiary company, and on such resolution being passed those books of accounts shall be open to inspection by those representatives at any time during business hours. The rights conferred by Section 138 upon members of a company may be exercised in respect of any subsidiary

company by members of the holding company as if they were members of the subsidiary company (Section 132A sub-sections 5 and 6).

Thus the new section of the Indian Companies (Amendment) Act of 1936, now makes it compulsory that the balance-sheet and profit and loss account together with auditors' report of the subsidiary company should be circulated along with the accounts of the holding company. This was laid down in response to a very strong demand from the Bombay Shareholders' Association and the investors for complete disclosure of the accounts of the subsidiary companies. The Select Committee also agreed with this view and laid down that " we also consider that when the holding company is a public company, subsidiary companies even if private companies should not enjoy exemptions from the provisions of Sections 83A, 86D, 87C, 87D, 91B, 91D, 144 sub-section (1), and 144 sub-section (5) clause 3."

PRELIMINARY AND FORMATION EXPENSES

Usually speaking, the promotion expenses which are called preliminary expenses of a company are not immediately debited to the profits of the company, but are in the first instance carried to an account specially opened known as the preliminary expenses account and treated as a capital expenditure for the time being (*Bale* v. *Cleland,* 4 *F.* & *F.* 117). The expenses which are correctly chargeable under this heading are the cost of registering the company, stamp duties and fees on its nominal capital as well as documents and contracts to be made at the time of promotion and incorporation, the preparing, printing, advertising and distributing the prospectus and the forms which accompany it, printing and preparation of accounts and memorandum of association, fees paid to valuers, accountants, lawyers, brokerage and underwriting commission, cost of books of accounts and stationery, printing of share-certificates, application and allotment letters, letters of regret, debenture bond certificates, debenture trust deeds,

cost of preparation of company's seal. In brief, all and every expense incidental to the promotion, formation and incurred right up to the period of allotment would fall under this heading of preliminary expenses. This preliminary expense item appears on the balance-sheet among the assets and is known commonly by businessmen and accountants as one of the "paper assets" of an intangible nature which should be written off as early as the profits of the company will permit. It is considered reasonable that this expenditure should be spread over a period of three to five years, to be gradually reduced from year to year by a debit to the profits of the company, because this is an expenditure, the benefit of which will be enjoyed by subsequent years. Of course this expenditure is not allowed, or instalments written off against profits are not allowed as a deduction from annual profits by the income-tax authorities (*Texas Land & Mortgage Co.* v. *Holtham,* (1894) 63 *L. J. Q. B.* 496). The cost of company's books and stationery and items such as that are however allowed. Some railways and other statutory companies permanently capitalise this expenditure but of course that is not desirable. A promoter can recover from the company only what he has actually paid towards preliminary expenses and that too in case he is able to prove a contract by the company to pay same (*English & Colonial Produce Co.,* (1906) 2 *Ch.* 435). It is usual to take power in the memorandum of association to pay preliminary expenses but even when they are not taken it has been held that a company would be justified in paying same including a commission for selling shares (*Licensed Victuallers Mutual Trading Association,* (1889) 42 *Ch.* 1).

PROFIT AND LOSS ACCOUNT

With reference to the profit and loss account the Indian Companies (Amendment) Act, 1936, makes specific reference and lays down that the profit and loss account along with the balance-sheet must be placed before the general meeting of the company as well as circulated among the members of

the company along with the balance-sheet by being addressed to every member of the company at least 14 days before the meeting at which it is to be laid. This profit and loss account has also to be audited by the auditors of the company. In case of non-trading companies an income and expenditure account has been provided for with the same conditions (Section 131). The Act further provides that the provisions of Table A clause 107 must be adopted by all companies in their articles of association and in any event the articles of every company shall be deemed to contain regulations identical with or to the same effect as the clause 107 of Table A (Section 17). The clause 107 runs as follows :—

The profit and loss account shall *in addition to the matters referred to in sub-section (3) of Section 132 of the Indian Companies Act, 1913,* show, arranged under the most convenient heads, the amount of gross income, distinguishing the several sources from which it has been derived, and the amount of gross expenditure distinguishing the expenses of the establishment, salaries and other like matters. Every item of expenditure fairly chargeable against the year's income shall be brought into account so that a just balance of profit and loss may be laid before the meeting, and, in cases where any item of expenditure which may in fairness be distributed over several years has been incurred in any one year, the whole amount of such item shall be stated with the addition of the reasons why only a portion of such expenditure is charged against the income of the year.

It will be seen from the above that now a duty is thrown upon the company management not only to circulate the profit and loss account among the members of the company along with the balance-sheet, which was not an obligation under the old act, but a specific indication is now given that the profit and expenditure items must be arranged under the most convenient heads distinguishing the several sources from which they have been derived or the heads under which the expenditure has been separately incurred. This was necessary because the Indian companies got into the habit of lumping up items of profit and expenditure in a manner which made it impossible even for an expert to distinguish one class of expenditure

from the other with a view to get an idea as to the directions in which the said expenditure was incurred, still less the headings under which the expenditure was allocated. In case of profits too this lumping up left the shareholders and investors entirely in the dark as to the departments in which the company was making profits and those in which it was losing.

PROFITS

It is thus important to ascertain what is exactly meant by the term "profits." In the ordinary commercial parlance, "profits" mean the excess of revenue of the current year, over the current year's expenditure, less loss sustained by fixed assets through wear and tear and depreciation. This is not exactly the legal view however. It is, of course a settled doctrine in any law that, profits only should be utilised in the payment of dividend, and that, it was illegal to pay same out of capital. However if the accretion of one asset is realised the same cannot be treated as profit while taking into account the result of the whole account (*Foster* v. *New Trinidad Lake Asphalt Co.*, (1901) 1 *Ch.* 208). Where the directors pay dividends out of capital, they have to make good the amount so paid (*In re. Oxford Benefit Buildings and Investment Society*, (1886) 35 *Ch. D.* 502). In this case it was also decided that "realised profits" as provided for in the articles must be taken in its ordinary commercial sense as meaning at least "profits tangible for the purpose of division," and not estimated profits. In *Lucas* v. *Fitzgerald,* (1905) 20 *T. L. R.* 16, where directors who were absent at the meeting when the interim dividend was declared, but were present at the subsequent meeting where the same was confirmed, were held not liable because it was held that they "must be taken to have believed that a proper investigation that justified the payment had taken place and there was nothing to suggest to them that a perfectly just expectation of profits had not been formed." The directors, however, who pay dividends out of capital have

a right to recover same by way of indemnity from those of the shareholders who at the time they took dividend knew that the same was so paid (*Moxham* v. *Grant*, (1900) 1 *Q. B.* 88). Such shareholders cannot even maintain an action against the directors to compel them to replace this amount (*Towers v. African Tug. Co.*, (1904) 1 *Ch. D.* 558). Where a manager was to receive as his remuneration a proportion of the net profits and was held that he should receive his share of the full profits without deduction of income-tax the company had to pay (*Johnstone* v. *Chestergate Hat Co.*, (1915) 2 *Ch.* 338). In case of debenture also it was held that where interest on them was payable only out of profits, the whole of profits must be applied for this purpose as far as necessary (*Heslop* v. *Paraguay Central Co.*, (1910) 54 *Sol. J.* 234). Under company law, however, according to *Moulton, L. J., in re. Spanish Prospecting Co.*, (1911) 1 *Ch. D.* 92, the profits are to be ascertained on the following basis, *viz.*:

"If the total assets of the business at the two dates be compared, the increase which they show at the later date, as compared with the earlier date, (due allowance, of course being made for any capital introduced into or taken out of the business in the meanwhile) represents in strictness the profits of the business during the period in question." In the course of the judgment, his Lordship admits that this legal conception of profits as applied to joint-stock companies is very difficult in practice, and therefore, in the usual profit and loss statement prepared in the business world this legal definition is seldom strictly followed. Thus, for example, a rise in the value of fixed assets such as business premises is seldom taken into account in connection with the profit and loss statement. In short, the tendency of the business world, according to his Lordship, is rather inclined to understate than overrate the profits. In strict law, however, as long as the dividends are not actually paid out of capital, but are declared out of profits as defined by *Moulton, L. J.* the directors will be within their rights, unless of course, the articles otherwise specifically provide. It may be further added that, on the question whether fixed capital loss during one year should be made good during the subsequent years out of profits, before a dividend can be declared, there are conflicting decisions. The earlier view of law being that such a provision was not necessary to be made, but in 1901 in *Dovey* v. *Cory*, (1901) *A. C.* 477, some doubt was

thrown on this proposition, though no definite view was expressed overruling the prior cases, as it was not necessary for the purpose of that particular case. Here, Lord Davey expressed himself as follows : " But I desire to express my dissent from some propositions of law which were laid down in the Court of Appeal, and upon which your Lordships thought it right to hear the respondent's counsel. The learned judges seem to have thought that a joint-stock company, incorporated under the companies act, may write off to capital, losses incurred in previous years, and may in any subsequent year, if the receipts for that year exceed out-goings, pay dividend out of such excess without making up the capital account. If this proposition be well-founded, it appears to me that a company whose capital is not represented by available assets need never trouble itself to reduce its capital . . . . in order to enable itself to pay dividends out of current receipts."

This is, however, an *obiter dicta* and it is unfortunate that no definite ruling was given on this point. Thus in *Ammonia Soda Co.* v. *Chamberlain,* (1918) 1 *Ch. D.* 266, it was held that the observation of their Lordships in *Dovey* v. *Cory* as cited above, cannot be considered as having overruled or qualified the previous decisions of the Courts of Appeal, and therefore the Court was bound to follow these decisions. In this case *Swinfen Eady, L. J.* said that "The Companies Acts do not impose any obligation upon a limited company, nor does the law require, that it shall not distribute as dividend the clear net profit of its trading, unless its paid-up capital is intact, or until it has made good all losses incurred in previous years." The three cases cited above by his Lordship in support of this proposition were:—

(1) *Lee* v. *Neuchatel Asphalte Co.,* (1889) 41 *Ch. D.* 1, where it was held to the effect that the company can, if so empowered to do by its articles, distribute as dividend all trading profits without making good the depreciation of the fixed assets.

(2) *Verner* v. *General & Commercial Investment Trust,* (1894) 2 *Ch. D.* 239, where also it was held that the trust company, or any other company under the Companies Act is not prevented from declaring and paying dividend, without having made good the lost part of its capital.

(3) *In Re. National Bank of Wales,* (1899) 2 *Ch. D.* 629, where *Lindley, M. R.* said:

"It is not possible for the Court to say that the law prohibits a limited company, even a limited banking company, from paying dividends unless its paid-up capital is intact."

In the same case (*Ammonia Soda Co.,*) *Swinfen Eady, L. J.,* distinguished "fixed" capital from "circulating" capital thus:—

"The distinction between 'fixed' capital and 'circulating' capital is not to be found in any of the companies Acts; it appears to have first found its way into the Law Reports in *Lee* v. *Neuchatel Asphalte Co.,* (1889) 41 *Ch. D.* 1, where *Lindley, L. J.* in his judgment adopted the expression which had been used by Sir Horace Davey in argument, derived from writers on political economy. It is necessary to consider the sense in which the expressions 'fixed capital' and 'circulating capital' were used in that case and in *Verner's Case,* (1894) 2 *Ch.* 239. What is fixed capital? That which a company retains, in the shape of assets upon which the subscribed capital has been expended, and which assets either themselves produce income, independent of any further action by the company, or being retained by the company are made use of to produce income or gain profits. A trust company formed to acquire and hold stocks, shares and securities, and from time to time to divide the dividends and income arising therefrom, is an instance of the former. A manufacturing company acquiring or erecting works with machinery and plant is an instance of the latter. In these cases the capital is fixed in the sense of being invested in assets intended to be retained by the company more or less permanently and used in producing an income. What is circulating capital? It is a portion of the subscribed capital of the company intended to be used by being temporarily parted with and circulated in business, in form of money, goods or other assets, and which, or the proceeds of which, are intended to return to the company with an increment, and are intended to be used again and again, and to always return with some accretion. Thus the capital with which a trader buys goods circulates; he parts with it, and with the goods bought by it, intending to receive it back again with profit arising from the resale of the goods. A banker lending money to a customer parts with his money, and thus circulates it, hoping and intending to receive it back with interest. He retains, more or less permanently, bank premises in which the money invested becomes fixed capital. It must not, however, be assumed that the division into which capital thus

falls is permanent. The language is merely used to describe the purpose to which it is for the time being appropriated. This purpose may be changed as often as considered desirable, and as the constitution of the bank may allow. Thus bank premises may be sold, and conversely the money used as circulating capital may be expended in acquiring bank premises. The forms 'fixed' and 'circulating' are merely terms convenient for describing the purpose to which the capital is for the time being devoted when considering its position in respect to the profits available for dividend. Thus when circulating capital is expended in buying goods which are sold at a profit or in buying raw materials from which goods are manufactured and sold at a profit, the amount so expended must be charged against, or deducted from receipts before the amount of any profits can be arrived at. This is quite a truism, but it is necessary to bear it in mind when you are considering what part of current receipts are available for division as profit."

The meaning of the expression "net profits" as given in Sec. 87C (3) of the Indian Companies (Amendment) Act, 1936, strictly applies to the purpose to which the section applies, *viz.*, for the calculation of the managing agents' remuneration. It of course does not go beyond that limited sphere.

A Precaution Re. the Question of Depreciation

This of course is the law at present but in view of the House of Lords' attitude in *Dovey* v. *Cory*, (1901) *A. C.* 477, it is wise for directors and company managers to see that proper provision is made out of profits for the purpose of writing off or replenishing wasting assets. They should also refrain from declaring dividends before making due provision for losses, either out of profits, or through the simple expedient of reducing the capital of the company to the extent the same is unrepresented by its assets, of course after obtaining the requisite consent of the Court in that regard. This should be done particularly in cases where the figure of lost capital is so heavy that the replacement of same through future profits seems difficult. Where depreciation has been written off out of profits during previous years on fixed assets, the same can be utilised towards payment of dividends in case the real value of the assets has not depreciated (*Bishop* v. *Smyrna Rail Co. No.* 2, (1895) 2 *Ch.* 596). On the same principle profits written off against goodwill can be applied towards

the payment of dividend (*Stapley* v. *Read Bros. Ltd.*, (1924) 2 *Ch. D.* 1).

According to late *Sir Francis Gore-Brown K. C.*, in his excellent book entitled "Hand-book on the Formation, etc., of joint stock companies" (26 Edn. p. 400);

"It is impossible to state any general propositions upon this point, with certainty but the following rules are suggested for the guidance of directors :—

(*a*) "Every company, as far as possible, should provide for unexpected losses by creating a reserve fund.

(*b*) "Provision should be made out of profits for replacing depreciation on wasting property, such provision being measured by the length of time during which the property may reasonably be expected to last; and in like manner sums should be set aside to allow for debts proving bad.

(*c*) "Accidents such as ordinarily occur should be made the subject of insurance, the premiums being paid out of profits, or a sum carried to an insurance fund.

(*d*) "If a loss occurs and the provision made in previous years is not sufficient to make good the amount, it may still be that the House of Lords will hold that no dividends should be paid until the loss is made good, although there is a strong ground for arguing that under such an article as Cl. 80 of the original Table A the loss might be spread over several years, the company paying a reduced dividend meanwhile.

(*e*) "If the loss is large so that it cannot be made good out of profits within a reasonable period, the capital should be reduced with the sanction of the Court."

The warnings and the directions given by late *Sir Francis Gore-Brown* in the above paragraph are no doubt the best to be borne in mind by those in charge of company management while dealing with the profits and accounts of same. The resultant effect of all the cases discussed above is that though depreciation of floating assets must be made good, the Courts will not insist on or compel a provision to be made from profits for fixed assets which are being used and gradually wasted in the business before a payment of dividend is made. However, looked from the pure consideration of business principle, the

necessity to provide for this profit in a separate reserve fund with the wasting assets, is of paramount importance if accounts are to be kept and business is to be managed on sound business principles. No businessman would insist on pushing an argument on the footing that you can arrive at your profit, which you can call net profit and which you can safely distribute, or spend out, unless your ascertained losses have been deducted therefrom and all depreciation charges have been provided for with a view to replace the fixed assets that are being wasted in course of their use in the business. In case of a joint-stock company, this prudent course is even more necessary than in case of private traders because here the trader or the partners of a firm of partnership are themselves owners, who remain in the business permanently and to them reduction of the book value of the assets or maintenance of it at the same old value will not make so much difference; but in case of a joint-stock company where the proprietors are constantly shifting and changing, provision for depreciation with a view to maintain the assets at the proper valuation must be made if the rights of members leaving the company, or entering it constantly, have to be equitably balanced and maintained.

The Indian Position Re. Moulton, J's. Decision in Re. Spanish Prospecting Company's Case

In connection with the above case discussed in the prior heading of profits, it is interesting to note that, fortunately for India, it is not possible to apply his Lordship's method of the ascertainment of profits of companies incorporated under the Indian Companies Act of 1913 on what is called as the single entry system. This is due to the fact that fortunately for India the balance-sheet of a joint-stock company, incorporated under the Indian Companies Act, 1913 has to be prepared in accordance with the form prescribed under Sec. 132 of that Act, called Form F. In this form under the heading of property and assets fixed capital expenditure has to be shown on

the lines indicated in that form. This form lays down that in case of assets in every case the original cost of the total depreciation written off under each heading must be shown. Thus a re-valuation of fixed assets at a higher figure cannot be entered in this form and thus profit on such realisation cannot be utilised for the purposes of dividends by our joint-stock companies. As we have already remarked whether such a course be legal or not, it would be a most undesirable and disastrous practice if the same were to be introduced in connection with ascertained of profits of joint-stock companies in this or any other country.

Profits made Prior to Incorporation

We have dealt with the question of profits made by a company in course of its business, but it frequently happens that when a company takes over a going business from a date prior to the date of its incorporation, profits are made within the interval and they have to be properly treated in accounts. Frequently under the agreement, arrangements are made to the effect that the company is entitled to receive this profit and not the vendor. If that is the case, as is usual in modern agreements, such profits are not available for dividend on the simple ground that a company cannot legally earn profits before its existence and a public company cannot do so until it has obtained a certificate entitling it to commence business. Under the circumstances such pre-incorporation profits are treated as capital profits and transferred to a special or capital reserve fund, as distinct from general or ordinary reserve fund, because the latter is a fund created out of profits and is virtually an accumulation of profits. This distinction between the two types of reserves has to be maintained, as otherwise, if these capital profits are mixed up with the general reserve fund accumulation of the working profits and paid out as dividend, the directors will be liable to refund the money on the footing of having paid dividend out of capital. When the vendor has thus given up his

right to pre-incorporation period of profit intervening between his agreement and actual incorporation of the company, it is usually provided that he should be paid an interest on his purchase amount. In that case this pre-incorporation profit may be utilised towards the payment of such interest, as a first charge. Thus capital profits may be utilised to make good any depreciation of fixed asset originally acquired by the company, or with a view to write down the goodwill; though it is not correct from a purely accountancy standpoint to utilise such profits for writing off preliminary expenses, because it is argued that this course would relieve the new company from the burden which it should equitably bear of writing off preliminary expenses out of future profits.

According to late *Prof. Dicksee*, the reason why profits made prior to incorporation should be treated as capital profits, in his book on " Advanced Accounting," 4th edition, page 98 is because :—

" In fixing the purchase price the vendor will doubtless have taken into account the probable amount of profits accruing between the date of the sale and the date of completion and will have increased the purchase price accordingly. In order, therefore, to arrive at the true purchase-price this loading must be deducted. If the assets acquired by the company include the item of goodwill, then some other fixed assets—preferably the most permanent—should be the one to be reduced. It is, however, perfectly legitimate to set off interest on purchase-money against accruing profits, with a view to avoiding the necessity of charging against revenue account interest accruing prior to the date upon which the company is entitled to commence business."

In connection with ascertainment of this profit or loss prior to incorporation, it is usual as far as it can possibly be done that, an actual stock be taken, because by this method alone a very accurate figure of profit or loss could be arrived at, failing that, the next best course is to ascertain such profits approximately by dividing the first year's trading into a period prior to incorporation and the other subsequent to incorporation and then apportioning the total profits or losses thus arrived at, either according to the time

or period or, according to the turnover. The division on the basis of time or period is arrived at by striking a ratio on the footing of period of time which it bears to the total period of time and thus bringing about a division. If on the other hand an apportionment has to be made on the basis of turn-over then the same method of striking a ratio on the footing of turnover and time has to be observed. It is stated that the latter method of apportionment is more accurate, particularly where there is a seasonal trade. While making this apportionment, care has to be taken to see that the expenditure which relates solely to the company must be charged against the profits subsequent to the date of incorporation, such expenditure being directors fees, preliminary expenses written off etc. Some accountants claim that a combination of both these methods would bring about a still more satisfactory result, *viz.*, that the gross profit may be apportioned according to turnover and the expenses apportioned according to time. Where this apportionment brings a loss for the period prior to incorporation such loss should be added to the goodwill because in reality it amounts to an increase of the purchase price. In case there is no goodwill, a goodwill account is recommended to be opened and debited with this loss or the same may be taken to a suspense account which may be extinguished by capital profits such as premiums on shares or debentures. Ultimately, the wisest course is to write this account off even from the ordinary trading profits over a period of years or as soon as circumstances would permit and it should not be allowed to remain as a paper asset on the balance sheet longer than can be helped by circumstances.

DIVISIBLE PROFITS

We have seen the state of law where no specific provision, describing or limiting the profits out of which dividends are to be paid is to be found in the articles, but where such a provision does exist, the articles must be carefully considered, before arriving at the decision as to what is the

exact figure of "divisible profits." In case where different classes of shares, such as preference and deferred are issued, care should be taken to see that the articles clearly lay down the rights of each class in connection with the division of profits, in order to avoid unnecessary confusion and litigation. Thus where the articles empower the directors to provide so much of the profits as they think necessary for the creation of a reserve fund, preference shareholders cannot insist on being paid their dividends without such a provision having been made (*Bond* v. *Barrow Haematite Steel Co.,* (1902) 1 *Ch. D.* 353; See also *Fisher* v. *Black & White Publishing Co.,* (1901) 1 *Ch.* 173; *Long Acre Press* v. *Oldham's Press,* (1930) 2 *Ch.* 196). In the same case it was decided that though the lost circulating capital must be kept up, it is not absolutely necessary in law to replace loss on depreciation of fixed capital. The other interesting ruling laid down by the learned judge here (*Farwell, J.*) was to the effect that it was

> "necessary to bear in mind that the two propositions (1) that dividends must not be paid out of capital, and (2) that dividends may only be paid out of profits are not identical, but diverse. The first is the requirement of the statutes, and cannot be dispensed with; the latter is in Table A or the Articles of the company...... A company which has a balance to the credit of its profits and loss account is not bound at once to apply that sum in making good an estimated deficiency in value of its capital assets. It may carry it to a suspense account or to reserve, and if the assets subsequently increase in value the amount neither has been or will be part of the capital. If therefore, a part of that balance is used in paying a dividend, that dividend is not paid out of capital, because the sum has never become capital, although it still remains a question whether it has been paid out of profits or not. On this point the decision whether these profits so treated could be applied to the payment of dividends depends upon whether the company "finally and irrevocably capitalised those profits."

This point was dealt with by *Russell, J.* in a later case (*Stapley* v. *Read Brothers, Limited,* (1924) 2 *Ch. D.* 1), where goodwill was written off out of profits and the directors wrote back to the profit and loss account so much of the depreciation as proved to be in excess of the

proper requirement, which step was objected to. In the judgment his Lordship observed that

> "if the company had kept their accounts in a different form, no difficulty would have arisen. If they had retained goodwill as an asset in their balance sheet, and if, instead of writing off its value out of profits, they had carried those profits to a goodwill depreciation reserve fund, they would have been at liberty at any time to distribute those profits, at all events to the extent by which the amount of such a reserve fund exceeded the amount of the actual depreciation. Does it make any difference that they have kept their accounts in another form, and that instead of placing the profits to a reserve account, they have purported to apply them in writing off a corresponding amounting of the value of the goodwill? The answer seems to me to depend upon the further question, have the company finally and irrevocably capitalised those profits so as to disentitle themselves for ever afterwards from restoring them to reserve and from dealing with them as profits"?

It was decided that they did not and therefore these were profits which were not capitalised. *In re. Fisher* v. *Black and White Publishing Co.*, (1901) 1 *Ch. D.* 173 where the memorandum of association of the company provided that the dividends were to be paid from "profits from time to time available for dividend," it was held that what was meant was that, such profits as were available after making all proper deductions for the purpose of paying dividends were divisible, and that this expression "available for dividend," when added to the word "profits" meant, when read in connection with the constitution of the company concerned, those left after proper provision by way of a reserve fund, either to meet contingencies of equalising dividends, or for repairing or maintaining the works connected with the business of the company had been made by the directors. This decision was mainly due to the fact that the memorandum of association of the company concerned particularly required these deductions to be made, and the directors had full discretion in the matter. In another case it has been held that there was no rule of law prohibiting the division of the profits of one year's trading merely because the trading

of the previous year had left a debit balance in the profit and loss account (*In re. Crichton's Oil Co.,* (1901) 2 *Ch. D.* 184). We have already seen that if the directors so desire, they can also treat the appreciation in the value of fixed capital assets as profits. Prixley in his book entitled "Duties of Auditor," (11th edition) page 588, quotes an unreported case, *viz., in re. The Midland Land and Investment Corporation,* heard before *Chitty, J.,* on 8th November 1886, in which the learned judge laid down that

> "In declaring a dividend, in my opinion, in trading concerns, the directors are entitled to put an estimate on the value of their assets from time to time, in order to ascertain whether there is, or is not, a surplus remaining after providing for liabilities (including, of course, paid-up capital), and where they made these valuations from time to time on a just and fair basis, and take all the precautions which ordinary prudent men of business engaged in a similar business would do, they are entitled to treat the surplus thus ascertained as profit."

In another case where the articles specifically provided that the directors should make due allowances for reserve fund, for maintenance, repairs, depreciation and renewals, it was held that what was here meant was that such dividends on ordinary shares should be declared only after restoring the tramway which the company was running to an efficient state, and after making due provision for that purpose out of the company's assets, but that as the holders of preference shares who were to be paid dividends according to articles out of "the profits of the particular year only," were entitled to be paid after providing a proportionate amount sufficient for the maintenance of the tramway for that year only, and that they cannot be deprived of their dividend in order to make good sums which had not been set aside in previous years (*Dent* v. *London Tramways Co.,* (1880) 16 *Ch. D.* 344). It is also correct to charge interest on moneys borrowed for the purpose of constructing work to the capital account, because there is no rule of law to compel companies to charge the same to revenue account (*Hinds* v. *Buenos Ayres*

Grand National Tramways Co., (1906) 2 *Ch. D.* 654). In case where the Memorandum contains the words "holders of preference shares shall be entitled out of the net profits of each year to a preference dividend, etc.," it was held that this did not mean cumulative dividend and that it meant ordinary preference (*Staples* v. *Eastman Photographic Materials Co.*, (1896) 2 *Ch.* 303). It may be further added that the good-will of a trading company is decided to be a fixed capital, and that while ascertaining profits it is not necessary to make good any depreciation in respect thereof (*Wilmer* v. *McNamara & Co.*, (1895) 2 *Ch. D.* 245). We have seen that the Articles frequently provide that the directors must lay aside a sufficient sum out of profits as reserve fund. Even where they do not so provide, it is both lawful and proper for the directors to create such a reserve if they so desire (*Evling* v. *Israel and Oppenheimer Ltd.*, (1918) 1 *Ch.* 101; *R. Paterson and Sons Ltd.* v. *Paterson,* (1916) *W. N.* 352); and in that case the Court shall have no jurisdiction to interfere (*Burland* v. *Earle*, (1902) *A. C.* 83).

PAYING DIVIDEND OUT OF CAPITAL

We have already seen that under no circumstance dividends can be paid out of capital. The leading cases on this proposition are *in re. Oxford Benefit Buildings and Investment Society,* (1886) 35 *Ch. D.* 502 *already quoted; Flitcrofts Case,* (1882) 21 *Ch. D.* 519; *in re. National Funds Assurance Co.*, (1878) 10 *Ch. D.* 118; *re. Sharpe,* (1892) 1 *Ch.* 154; *in re. Alexander Palace Co.*, (1882) 21 *Ch. D.* 149. This rule applies strictly irrespective of the fact whether the memorandum of association or the articles of association authorise such a payment, because the Companies Act prohibits the reduction of capital in any manner not authorised by the Act (*Verner* v. *General Investment Trust,* (1894) 2 *Ch.* 239; *Guinness* v. *Land Corporation of Ireland,* (1882) 22 *Ch. D.* 349; *McDougall* v. *Jersey Hotel Co.*, (1864) 2 *H. & M.* 528; *Trevor* v. *Whitworth,* (1888) 12 *A. C.* 409). Neither can a general meeting of a company

justify a payment of dividend out of capital (see *Flitcroft's Case above*). The directors who are responsible for the payment of dividend out of capital are personally responsible to make good the amount according to the same (*Flitcroft's Case*) jointly and severally. (See also *Oxford Benefit Building Society*, (1886) 35 *Ch. D.* 502). Of course where the directors paid dividend *bona fide* relying upon valuation of assets by experts, though the valuation subsequently proved wrong or an overestimate they would not be responsible (*Stringer's Case*, (1869) *L. R.* 4 *Ch. App.* 475). The directors who paid a fictitious dividend in order to raise the price of the company's shares would be criminally liable for conspiracy (*Burnes* v. *Pennell*, (1849) 2 *H. L. C.* 497 *at page* 525; *Regina* v. *Esdaile*, (1858) 1 *F. & F.* 213). Not only are the directors liable but the shareholders who received dividends with full knowledge that the same were paid out of capital may be ordered to indemnify the directors to the extent of what they received (*Moxham* v. *Grant*, (1900) 1 *Q. B.* 88). On the same principle the shareholders cannot sue the directors to restore the amount paid out by them wrongfully by way of dividend and at the same time retain the dividends themselves (*Towers* v. *Africa Tug. Co.*, (1904) 1 *Ch.* 558). Directors who declare and pay dividends out of borrowed money and publish fictitious balance sheets are criminally liable under the Indian Penal Code (*Queen* v. *Moss*, (1894) 16 *All.* 88). We have already seen that the dividends are declarable out of the amount set aside by the directors or earmarked by them as divisible, because generally the articles of association authorise them to make proper reserves out of profits before recommending dividends and in such cases shareholders cannot insist on payment of higher dividends than the amount which the directors have decided to be fairly divisible by way of dividends would warrant (*Bombay Burma Trading Corporation* v. *Dorabji Cursetji Shroff*, (1886) 10 *Bom.* 415). If articles however do not contain such clauses or they are altered, then the amount to be divided by declaration as dividend would be a matter to be

decided by the vote of majority at the company's meeting, with which vote the Court will not interfere (*Burland* v. *Earle*, (1902) *A. C.* 83). In case where an interim dividend is declared, the same does not necessarily create a debt and thus the same may be rescinded by the directors through a resolution (*Lagunas Nitrate Co.* v. *Schroeder*, (1901) 85 *L. T.* 22). Once a dividend is properly declared it becomes a debt and until then the shareholder cannot sue for it (*Bond* v. *Barrow Haematite Steel Co.*, (1902) 1 *Ch.* 353; *Severn Bridge Ry. Co.*, (1896) 1 *Ch.* 559). Frequently when a company is sold, the vendor guarantees payment of dividends on the shares of the company, which guarantee would be valid and enforceable (*Re. South Llanharran Colliery Co.*, (1879) 12 *Ch. D.* 503; *Addison* v. *Ness*, (1893) 9 *T. L. R.* 607). In such cases it has been held that there was no implied contract on the part of the company to carry on the business during the whole of the period and thus it would not be disentitled to enforce the guarantee if it discontinued its business (*Brown & Co.* v. *Brown*, (1877) 36 *L. T.* 272). Of course the company was free to release the guarantee if it so desired (*Sheffield Nickel & Co.* v. *Unwin*, (1877) 2 *Q. B. D.* 214). Discontinuance of one business out of a number of businesses carried on by the company will not release the vendor in such cases. (See *Brown & Co.* v. *Brown* above). Payments made under such guarantees are not assets of the company which can be claimed by creditors (See *South Llanharran Colliery Case above*). A guarantee given by a vendor for payment of certain dividend and for a fixed period may be voted in case it is only a personal liability (*Ex parte Jegon*, (1879) 12 *Ch. D.* 503). If however it turns out that the arrangement results in the payment of dividend directly or indirectly out of the purchase price the arrangement is void as against the creditor and the company (*Re. Menell*, (1915) 1 *Ch.* 759).

In connection with the payment of dividend, a distinction is made where the business of the company is to deal in stocks, shares and stock exchange securities, where the company is bound to write off the losses in the year's

transaction in these securities before a dividend is declared; but where the company is a trust company and its business is to hold investments the surplus income after paying expenses may be divided, even though the capital value of investments is reduced (*Verner* v. *General Investment Trust,* (1894) 2 *Ch.* 239). It will thus be seen that where investments are held as capital assets the profit of reselling them may be taken, but the losses need not strictly be written off, whereas in the other case where they form the article for business on the same footing as goods, the loss had to be written off before a net divisible balance of profits could be arrived at. On the same principle where a company sells its business and makes a profit, the same may be divided as dividend or bonus among its shareholders (*Lubbock* v. *British Bank of South America,* (1892) 2 *Ch.* 198). The profits which are carried to reserve fund naturally retain their position as profits and can be divided among the shareholders by way of dividend at any time unless they are capitalised as we shall see later (*Hoare & Co. Ltd.,* (1904) 2 *Ch.* 208). It has been decided that good-will cannot be distributed as profit (*Spanish Prospecting Co.,* (1911) 1 *Ch.* 92 at page 105). A bonus paid in cash as a capital distribution paid out of sale proceeds of capital assets is income (*Re. Bates,* (1928) *Ch.* 682; *Hill* v. *Permanent Trustee Corporation,* (1930) *A. C.* 720).

DECLARATION OF DIVIDENDS

With reference to declaration of dividend, certain general principles have to be remembered. When the shares are divided into different classes, the articles usually provide for the regulations under which the dividends are to be paid and the rights of each class of shareholders to a share in the profits. In some rare cases these rights are mentioned, as we have seen already, in the memorandum of association. These dividends are declared usually with respect to a certain definite period and are payable as declared on or after a certain date. If meanwhile, that is after declaration of dividend and actual payment, death

occurs of the owner of shares, the dividends are not apportionable according to Indian law, as at the date of death, unless the proprietor by his will or by deed, while disposing of the shares, had declared the dividends to be so apportionable (*Phirozshaw B. Petit* v. *Bai Goolbai*, (1922) *L. R.* 50 *Indian App.* 276; (1923) 47 *Bom.* 790 (*P. C.*)). This is because the English Apportionable Acts do not apply to India. In case of cumulative dividends paid in a particular order, it has been decided that as between the tenant for life and the remainder man, they are to be treated as dividends for the year in which they are declared (*Re. Wakley,* (1920) 2 *Ch.* 205). Where arrears of dividend are paid in case of cumulative preference shares, as recoupment, such dividends also are treated as dividends of the year in which they are declared (*Re. Marjoribanks,* (1923) 2 *Ch.* 307) where, however, owing to the shares being issued on different dates, the amount of arrears differed, it was held that the dividends were declared in proportion to the arrears outstanding (*First Garden City* v. *Bonham-Carter,* (1928) 1 *Ch.* 53). The dividends of course are payable in cash unless the articles provide for payment of same by issue of fully or partly paid shares or in debentures or in specie (*Wood* v. *Odessa Water Works,* (1889) 42 *Ch. D.* 636). Certain articles of association of Indian companies provide for the right to pay dividends in specie. Frequently articles of association contain clauses that if a dividend is not claimed within a stipulated period, it will not be payable and this period is much lesser than that which the Limitation Act provides, though this stipulation is objected to by the committee of the Stock Exchange, it is legal and binding and is likely to be strictly construed (*Ward* v. *Dublin North City Milling Co.,* (1919) 1 *Ir. R.* 5). Frequently shares are sold on the stock exchange as *cum div.* Here according to the contract the bearer is entitled to the dividend declared after the date of the contract for sale, but that position does not affect the company which is only bound to pay the dividend to the party whose name happens to stand on the register of transfers on the date

fixed by it at the time of declaring dividends (*Black* v. *Homersham*, (1879) 4 *Exch. D.* 24; *Re. Kidner*, (1929) 2 *Ch.* 121).

Where there are two joint holders and the company gave notice of the dividends declared to the first named and even continued to give such notice after knowledge of his death, it was held that a forfeiture of dividends was invalid (*Ward* v. *Dublin North City Milling Co.*, (1919) *Ir. R.* 5).

In case where shares carry cumulative preferential dividend and the company fails to pay same during any year because profits were not sufficient that does not constitute a debt for the amount which would have been paid if there were profits. It is on this ground that the cumulative dividend paid is not considered a dividend of the years in arrear, but is treated as a dividend in respect of the year during which the dividend was paid. In other words the amount may be an amount of arrears but as far as the dividend is concerned it is the dividend of the year during which it was declared (*In re. Wakley*, (1920) 2 *Ch.* 205). If dividends are paid wrongfully, that is out of capital, not only the directors but even the auditors who are the parties to such payment are liable to proceedings by action, or in case of winding up by misfeasance summons, and the amount improperly paid may be recovered from them with interest (*Re. Denham & Co.*, (1883) 25 *Ch. D.* 752; *Prefontaine* v. *Grenier*, (1907) *A. C.* 101). Generally speaking the Courts will not compel directors to declare dividends against their judgment as they are responsible for the proper management of the concern entrusted to them through the action of shareholders themselves though through the action of shareholders the Court may intervene to restrain the payment of an improper dividend (*Lambert* v. *Neuchatel Asphalte Co.*, (1882) 51 *L. J. Ch.* 882; *Bond* v. *Barrow Haematitie Steel Co.*, (1902) 1 *Ch.* 353; *Hoole* v. *Great Western Rail Co.*, (1868) 3 *Ch. App.* 262). The payments of dividend are thus restrained where provisions for expenses which must be met out of income has not been

made (*Stringer's Case*, (1869) 4 *C. App.* 475, also *re. Neuchatel Case, above*).

Interim Dividends and Set-off of Calls

The dividends of course are declared or sanctioned by annual meetings at the time when the accounts are presented to them which as we have seen, must not exceed the amount recommended by the directors. This is of course subject to the right of directors under the articles to declare interim dividends which is a dividend declared at some date between ordinary general meetings. These interim dividends are naturally the result of estimates made on proper enquiry and declared after they are satisfied that there will be sufficient profits (*Lucas* v. *Fitzgerald*, (1905) 20 *T. L. R.* 16; *Towers* v. *African Tug Co.*, (1904) 1 *Ch.* 558). In connection with these interim dividends when declared under the proper powers, the Court will not interfere with their declaration at the instance of a shareholder (*Lever* v. *Land Securities Co.*, (1891) 8 *T. L. R.* 94). Frequently the articles provide that the dividends may be set-off as against calls due from shareholders, which article would be binding and apart from such an article and in absence thereof such dividends could be set off against calls before winding up commences.

Manner and Method of Payment

The articles also state the proportion in which the dividends are to be paid as between the members, because in absence of such a provision the dividends are payable in proportion to the nominal amount of the share capital held by each member irrespective of the amount paid up and thus an injustice may be done to the shareholders because here the shareholder who has fully paid his share may get the same amount as one who has not paid up the full amount of same (*Oak Bank Oil Co.* v. *Crum*, (1882) 8 *A. C.* 65). Thus in practice articles are always to be found laying down definitely that dividends are to be paid according to the amounts paid on the shares. It should

be noted that profits which are earned after the winding up has commenced are divisible as capital and not profits (*Bishop* v. *Smyrna Ry. No.* 2, (1895) 2 *Ch.* 596; *re. Armitage,* (1893) 3 *Ch.* 337). It has been decided that once a company estimates a proper amount for which it has made a profit, it can proceed to pay dividend without waiting to realise all the assets in connection therewith (*Stringer's Case,* (1869) 4 *Ch.* 475). A company while it is selling its main assets may reserve certain assets for the purpose of paying dividend (*Re. Thomas,* (1916) 1 *Ch.* 383 at page 393; (1916) 2 *Ch.* 331). A company cannot pay its dividends by distributing debentures unless it has express powers to do so in its articles (*Wood* v. *Odessa Water Works,* (1889) 42 *Ch. D.* 636). The same rule applies to a dividend payable in shares (*Bouch* v. *Sproule,* (1887) 12 *A. C.* 385; *Commissioners of Inland Revenue* v. *Blott,* (1921) 2 *A. C.* 171; *Hoole* v. *Great Western Ry. Co.,* (1867) 3 *Ch.* 262). Care must of course here be taken to see that the amount actually payable by way of dividend is the amount which is to be credited as paid up on each share.

According to Table " A," clause 95, the company in general meeting is empowered to declare dividends, but it is laid down that no dividends so declared shall exceed the amount recommended by the directors. This clause is now one of those regulations under the Indian Companies (Amendment) Act, 1936, S. 17 (2) *which a company may adopt and the articles shall in any event be deemed to contain regulations identical with or to the same effect.* This clause virtually provides to the effect that no dividend shall be paid otherwise than out of profits.

It is also frequently laid down in the articles, as it is laid down in Table " A," clause 102, that no dividend shall bear interest against the company. Besides the final dividends, directors, when so empowered by the articles, declare what is called an interim dividend. An interim dividend is a dividend declared any time between two ordinary general meetings. The wording of the resolution

would indicate the period for which such interim dividend is declared (*Re. Jowitt,* (1922) 2 *Ch.* 442). If, after declaring such an interim dividend, the directors find that in doing so they were mistaken, they may cancel the declaration at any time before the payment (*Lagunas Nitrate Co.* v. *Schroeder & Co.,* (1901) 85 *L. T.* 22). But it is no doubt that it is the duty of the directors to satisfy themselves before declaring such an interim dividend, that there were profits to divide (*Towers* v. *African Tug Co.,* (1904) 1 *Ch. D.* 558). Acccording to *Alverston, C. J.,* in *Lucas* v. *Fitzgerald,* (1905) 20 *T. L. R.* 16 "the declaration of interim dividend depends much more upon estimates and agreements than the declaration of a final dividend, which is made upon information contained in the formal balance-sheet."

If however, the articles clearly state that the dividends are to be paid out of realised profits only, the directors may be liable in case they pay dividends out of estimated profits (*In re. Oxford Benefit Building Society,* (1886) 35 *Ch. D.* 502). If however, the directors rely upon the judgment, information or advice of the chairman, general manager, or other responsible and trusted officer of the company while arriving at their decision as to the declaration of dividends, they will be protected, unless there was some ground for suspicion. In *Kingston Cotton Mill Co. No.* 2, (1896) 2 *Ch.* 279 where the stock-in-trade was grossly overstated in accounts from year to year, which stock was taken on the basis of a certificate signed by the managing director, the other directors, who, relying on the balance-sheet on the basis of this stock and signed by the company's auditors, sanctioned dividends, were exonerated from liability, and so also were the auditors, because it was held here that it was no part of the duty of the auditors to take stock and thus they were justified in placing implicit reliance on the certificate of the manager. The same principle was acknowledged in *Dovey* v. *Cory,* (1901) *A. C.* 477. It has also been held that in case there is a *bona fide* increase in the value of the fixed assets, the said increase can be

utilised for the purpose of writing off any debit balance that may be standing on the company's profit and loss account, with a view to be able to pay dividends out of current profits (*Ammonia Soda Co.* v. *Chamberlain,* (1918) 87 *L. J. Ch.* 193).

Limitation on Dividends

With reference to the period of limitation applying to dividend declared, it has been decided in a recent full bench case that a suit for dividend declared is a suit for debt and not for compensation on a breach of contract and Art. 120 of the Indian Limitation Act, 1908, applies; under this article the period laid down is six years from the date the right to sue accrues (*Venkata Gurunatha A. R. Seshayya* v. *Sri Tripirasundari Cotton Press,* (1926) 49 *Mad.* 468). In English Law, however, this period is twenty years from the date of declaration (*Artisans' Land & Mortgage Corporation,* (1904) 1 *Ch. D.* 796).

Accretion and Profits as Dividends

Where a company is entitled to borrow, this borrowing cannot be treated as a separate business with a view to get a dividend wrongfully paid through accretion of capital as in one case where debentures were redeemed at a discount and an attempt was made to treat that profit as distributable as dividend in spite of the fact that the other assets had depreciated, the same was held by the Court to be wrongful (*Wall* v. *London and Provincial Trust,* (1920) 1 *Ch.* 45; (1920) 2 *Ch.* 582). When the articles provide that dividends can only be paid out of the profits of the "business" of the company capital accretions cannot be utilised as dividends (*Bond* v. *Barow Haematite Steel Co.,* (1902) 1 *Ch.* 353). Where even the reserve fund is invested in the business itself, the Court will not interfere if dividend is sought to be paid out of it on the ground that the same have been dedicated to capital (*Hoare & Co.,* (1904) 2 *Ch.* 208; *re. Alsbury,* (1890) 45 *Ch. D.* 237). The

company no doubt is entitled to deduct income tax which it has paid unless it has declared same free of income tax and where the company is paying in shares its dividend, according to the powers reserved to it in its articles, it should take care to see that the amount credited on each share so issued is the amount of dividend less the income tax unless this dividend also has been declared free of income tax (*Ashton Gas Co.* v. *Attorney General,* (1906) *A. C.* 10; *Samuel* v. *Inland Revenue Commissioners,* (1918) 2 *K. B.* 553). Super-tax or sur-tax is not payable in respect of a share dividend which has been properly capitalised (*Commissioners of Inland Revenue* v. *Blott,* (1921) 2 *A. C.* 171). Dividends payable in shares are treated as shares issued for a consideration other than cash, as we have seen already and must be treated accordingly. We have already seen that in case of articles which give a lien to the company on its own shares, the said lien also includes the right of forfeiting the dividend.

Capitalisation of Profits

We have already seen that when powers are given in the articles, the company can convert its dividends into shares and thus capitalise its profits. This applies to debentures also, issued in lieu of dividends. If a bonus in form of shares is given and if the shares are not of the same company but of some other company, the same is liable to super-tax, though purely shares and debentures issued in lieu of dividend of the same company are not so liable (*Pool* v. *Guardian Investment Trust,* (1922) 1 *K. B.* 347; *Inland Revenue Commissioners* v. *Fisher's Executors,* (1926) *A. C.* 395; *Inland Revenue Commissioners* v. *Blott,* (1921) 2 *A. C.* 171). If, however, the shareholder is given an option either to take the dividend in cash or in shares, the distribution is not treated as that of capital and thus is liable to super-tax (*Inland Revenue Commissioners* v. *Coke,* (1926) 2 *K. B.* 246). A bonus which is paid in cash and declared by the company to be a capital distribution representing a sale of capital assets is income (*Re. Bates,*

(1928) 1 *Ch.* 682; *Hill* v. *Permanent Trustee Corporation,* (1930) *A. C.* 720; see also *Andrew* v. *Thomas,* (1916) 2 *Ch.* 331; *Hockin* v. *Hatton,* (1917) 1 *Ch.* 357; *Armitage* v. *Garnett,* (1893) 3 *Ch.* 337).

Interest out of Capital

We have already noted the well-known rule of company law, *viz.*, that dividends cannot be paid out of capital, but should only be paid out of profits. To that well-known rule there is an exception provided for by Sec. 107 where a company whose shares are issued for the purpose of raising money to defray the expenses of the construction of any works or buildings or for the provision of any plant which cannot be made profitable for a lengthened period, the company may pay interest on so much of that share capital as is for the time being paid up, and may charge same to capital, as part of the cost of construction of the work, or building, or for the provision of plant. A power has to be taken in the articles for this purpose, or else, a special resolution will be necessary to give effect to this payment. In either case, previous sanction of the local government has to be obtained. The local government before sanctioning such payment may, at the expense of the company, appoint a person to enquire and report as to the circumstances of the case, and may, before making the payment, require the company to give security for the payment of the costs of the enquiry. The payment shall be made only for the period as may be determined by the local government, and such period shall in no case extend beyond the close of the half year next, after the half year during which the work or buildings have been actually completed or the plant provided. The rate of interest shall in no case exceed 4 per cent. per annum. The Governor-General in Council may, by notification in the Gazette of India, prescribe a lower rate. Further it is provided that the accounts of the company shall show the share capital on which, and at the rate at which, interest has been paid out of capital during the period to which the accounts relate.

RESERVE FUND

Frequently, joint stock companies lay aside a certain sum out of profits under the heading of "reserve fund." This reserve may be made either with a view to provide a fund out of which any unexpected emergency may be met with and is known as "general reserve." Besides thus laying aside amounts from profits from time to time, a certain proportion of profit is also set aside to meet some estimated loss of a more or less recurring type, such as, bad debts, depreciation, etc. This reserve is known among accountants as "specific reserve." There is, of course, no definite ruling of law, apart from that which the company itself may provide for in its articles, compelling the directors to provide for contingencies. This reserve fund is sometimes invested in outside securities, and sometimes allowed to remain in the business as so much additional working capital. There is no objection to either of these two courses being followed, *i.e.*, reserve fund may be invested in the business itself of the company, without the same being required to be kept separate from other assets (*In re. Hoare & Company Ltd.*, (1904) 2 *Ch. D.* 208). Frequently the articles of association contain a clause empowering directors to set aside out of the profits of the company, such sums as they think proper as a reserve, or reserve fund, which shall, at the discretion of the directors, be applicable to meet contingencies, or for equalising dividends, or any other purpose to which the profits of the company may be properly applied. Powers are also given under which the directors may, at their discretion, employ the said reserve fund in the business of the company, or invest it in such investments (other than shares of the company itself) as the directors may from time to time think fit. (Cl. 99, Table A). When such powers are given to the directors, they have complete freedom in determining that amount which they think necessary and proper to lay aside, before determining the balance of divisible profits and this course may be pursued in spite of the fact that it may prevent the payment of dividends altogether (*Fisher* v. *Black & White*

Publishing Co., (1901) 1 *Ch.* 173). We have here talked about the reserve fund being created from the profit and loss account. Frequently, unexpected profits, such as premium on shares sold by the company, etc., are credited to the reserve fund account. In this connection it may be mentioned that there is no obligation in law to credit this type of profits to the reserve fund account. The same may be distributed as profits, and dealt with in any lawful manner as the profits of the company may be dealt with. It may be further mentioned, that a reserve fund which has been created from profits of past years, remains nothing more than a balance of accumulated profits, and is thus divisible among members in case of liquidation on the same lines as the profits, and that the mode of application will largely depend upon the privileges enjoyed by each class of shareholder according to the company's constitution.

The next point is whether the profits accumulated by way of reserve fund could be paid out in form of fully paid shares. This operation is known as " capitalisation of profits," which we have dealt with above. In *Commissioners of Inland Revenue* v. *Blott*, (1920) 1 *K. B.* 114, the company declared a bonus out of its undivided profits, having power in the articles to do so, to be paid in fully paid shares, it was held that this was an addition to capital of the shareholder and not his income and therefore no super-tax was payable. This was upheld in the House of Lords (*Commissioner of Inland Revenue* v. *Blott and Greenwood,* (1921) 2 *A. C.* 171).

Reserve Account and General Reserve (Distinction)

There has been some controversy among accountants in England and a certain section have suggested that the term " reserve fund " should be conveniently employed in case of reserves created out of profits which are invested in securities outside the business and that the term " reserve account " should be applied to the reserve fund which is utilised in the business itself. Of course, there is considerable difference of opinion on this point even among

the accountants, but as far as the law is concerned it acknowledges no such distinction and unless the articles specifically compel the directors to invest the reserve fund in outside securities, they are not bound to do so. Generally speaking, it is wise and desirable that the reserve created for specific purposes, such as for the purposes of sinking fund, insurance funds and depreciation funds, should be invested in outside securities. Of course, specific reserves which are created against anticipated losses are treated in accounts as charges on the profits, whereas the general reserves are treated as appropriations of profits available for dividend at a future date. The usual practice of accountants is to show specific reserves by way of deduction from the assets against which they are made, as is suggested by our Form F of balance-sheet. The general reserves, on the other hand, are shown on the liabilities side of the balance-sheet.

Generally speaking, general reserves are not made for any definite purpose but for purposes of contingencies the specific reserves, such as that for sinking fund, is created for the specific purposes of either repaying a debenture loan or replacing a wasting asset. In case of banking companies where reserve funds are created for the purpose of strengthening the credit of the concern, it is doubtless desirable that they should be invested in outside gilt-edged securities. Reserves are created for various other purposes such as reserves for bad debts and here what is actually done is that the bad debts actually suffered are written off by a debit against the reserve for bad debts created during previous year and a credit balance is carried down equivalent to the extent of the new reserve that is necessary on the footing of the sundry debtors of the year for which the accounts are closed. The difference between these two accounts then represents the amount necessary to debit to the profit and loss account which is composed of the actual bad debts written off after the adjustment of opening and closing reserves. In some accounts the actual bad debts written off are separately shown in the profit

and loss account apart from the readjustment of the reserves. There are sometimes reserves created for discounts, which is a provision against the cash discount which are likely to be paid to the sundry debtors if they paid up their debits within a specified time. However, accountants are not united in their opinion as to whether this particular type of reserves should be created and the matter is entirely optional as far as the company accounts are concerned. Frequently reserves are created for depreciation of investments under the heading of " Investment Reserve Account " by transferring a particular sum from the profits to this account. This reserve account is then adjusted from time to time as the circumstances may warrant.

Alterations in Reserves

It should be remembered that the reserve fund accumulated out of profits retains the nature of it being an accumulation of profits and therefore in case the articles provide that the preference shareholders are entitled to certain proportion of profits and there are arrears of preference dividends, they will be entitled to such arrears out of the reserve fund (*Bishop* v. *Smyrna & Cassaba Ry. No.* 1, (1895) 2 *Ch.* 265). But where the articles provide that before a dividend can be paid to preference shareholders, a resolution to pay such dividend must be passed by the directors and prior to the passing of such resolution winding up supervenes, the preference shareholders shall not have any claim on the reserve fund in connection with arrears of dividends (*Crichton's Oil Co.*, (1901) 2 *Ch.* 184; (1902) 2 *Ch.* 86). If the preference shareholders have been fully paid off their dividends from year to year and there is no arrear, the reserve fund naturally belongs to ordinary shareholders exclusively (*Bridgewater Navigation Co.*, (1891) 1 *Ch.* 155; 2 *Ch.* 317).

In a recent case *Angostura Bitters* (*D. J. G. B. Siegert & Sons, Ltd.* v. *Kerr,* (1933) *A. C.* 550), where the memorandum of association provided for a dividend of 8 per cent. on preference shares and thereafter it provided that 10

per cent. were to be carried to a reserve fund until £50,000 were accumulated, this reserve fund was to be invested outside the business, it was also provided that the preference shareholders were to have priority as to the return of capital. The memorandum was silent as to the purpose for which this reserve was to be applied, but the articles of association empowered the directors to provide a reserve fund for general purposes. It was decided that the reserve fund created in accordance with the memorandum of association was created for the benefit and security of preference shareholders. It was also decided that the guarantor of preference dividends who had made payment of preference dividends pursuant to the guarantee can claim only to be "subrogated" to the rights of the preference shareholders and cannot claim to be repaid as a creditor of the company (*In re. Walter's Deed of Guarantee* v. *Walters*, (1933) 1 *Ch.* 321; (1933) *W. N.* 29).

Where the articles fix the creation of reserves for specific purposes, they can be altered and the reserve fund applied in a way inconsistent with the provision in the article, provided the same is done after the alteration is carried out (*Walker* v. *London Tramways Co.*, (1879) 12 *Ch. D.* 705; *Eastern & Australian Steamship Co.*, (1893) 68 *L. T.* 321). Powers may also be taken to create a reserve fund where the articles do not give such powers by inserting such an article through a special resolution (*Binney* v. *Ince Hall Coal Co.*, (1866) 35 *L. J. Ch.* 363). A company can also carry forward any profit without creating a reserve (*Burland* v. *Earle*, (1902) *A. C.* 83).

Secret Reserve

Besides creating a reserve fund in the usual manner, *viz.*, a transfer from the profit and loss account to a special heading of reserve fund account, which is in the usual course, exhibited on the balance-sheet under the heading of "reserve fund" it is the practice with some companies to create what is known as a "secret reserve." The object of this secret reserve is to provide a medium

out of which losses can be secretly met with, thus preventing undue loss of credit through their publication. This course, it is urged, is the interest of companies carrying on business of a nature which to a large extent depend on their credit, such as banking institutions. This is done through the application of any one of the following methods :—

(1) over-depreciating fixed assets,
(2) over-creation of reserve for bad and doubtful debts,
(3) debiting capital expenditure to revenue,
(4) under-valuing stock in hand,
(5) writing off goodwill.

There is no doubt considerable difference of opinion among accountants and businessmen as to the advisability of this course being followed. The strongest objection to it being that the same might lend itself to the company's fund being misused for the personal advantage of the directors or their friends. The position of law in this connection is uncertain as the only case decided on the same subject is *Newton* v. *Birmingham Small Arms Co. Ltd.*, (1906) 2 *Ch.* 378, which was largely influenced by Sec. 23 of the English Companies Act of 1900, which has been considerably altered by the English Act of 1908. It is the latter Act which our Act of 1913 largely follows. This case, however, brings out the point, *viz.*, that the auditor is not bound to disclose the fact that the financial position of the company is better than what is actually shown on the balance-sheet, though, of course, the company according to this decision, cannot by resolution or otherwise, deprive the auditor of his right to state in his report such matters as the law obliges him to do in connection with the accounts of the company. It was further remarked that the principle to be followed by the auditor was that, where such a secret reserve was created for a legitimate purpose, and that there was no room for suspicion, they may use their discretion and decide not to disclose this secret reserve in their report. In this case the actual facts were, that the company passed

resolutions altering their articles, by which alterations they empowered the directors to set aside sums out of profits without disclosing them on the balance-sheet under the heading of "reserve." This clause also empowered the directors to invest the said reserve in outside securities, and further it was laid down that the auditors were also not to disclose any information with regard to this reserve to the shareholders. The Court of course came to the conclusion that, the first part of the resolution empowering non-disclosure of reserve to the shareholders was not quite objectionable, but the second part which compelled the auditors to act in a manner inconsistent with the obligations imposed on them by the Act of 1900, were *ultra vires.* In his judgment, *Buckley, J.*, made the following remarks :—

"The special resolutions in the present case provide that the balance-sheet shall not disclose the internal reserve fund. It must therefore omit on the assets side of the balance-sheet the assets which make up the amount standing to the credit of that fund, and the contra item—namely, the credit balance of the fund—on the liability side. The result will be to show the financial position of the company to be not so good as in fact it is. If the balance-sheet be so worded as to show that there is an undisclosed asset, whose existence makes the financial position better than that shewn, such a balance-sheet will not, in my judgment, be necessarily inconsistent with the Act of Parliament. Assets are often, by reason of prudence, estimated, and stated to be estimated, at less than their probable real value. The purpose of the balance-sheet is primarily to show that the financial position of the company is at least as good as there stated, not to show that it is not or may not be better. The provision as to not disclosing the internal reserve fund in the balance-sheet is not, I think necessarily fatal to these special resolutions. The Act, however, provides that the auditors shall report to the shareholders on the accounts examined by them. These auditors will examine, amongst others, the accounts of the internal reserve fund. A principal question in this case, I think, is whether it is a compliance with these words of the act that the auditors shall report that they have examined the accounts as to the internal reserve fund, that they are satisfied with them, and that the funds have been employed in manner authorised by the company's regulations, or whether there will be default in complying with the act if they do not go on to say how the fund has been employed. In my judgment such a report

would be a sufficient report within the Act if the auditor is *bona fide* satisfied that in making this report, and nothing further, he is truly reporting as to 'the true and correct view of the state of the company's affairs.' But the special resolutions do not stop there. They provide that it shall be the duty of the auditor not to disclose any information with regard to this fund to the shareholders or otherwise. It is, I think, inconsistent with the Act of Parliament that the auditor shall be bound, even when he thinks that the true state of the company's affairs is affected by facts relating to the internal reserve fund, to withhold information with regard to the same from the shareholders. If, for instance, the directors had invested the internal reserve fund upon investments which might involve the company under certain circumstances in enormous loss, the Act, I think, requires that the auditor shall be at liberty and be bound to report that fact. In reporting upon the accounts submitted to them the auditors do not, of course, report as to the details of accounts to which they find no cause to take exception. Their duty is to call the attention to that which is wrong, not to condescend upon all the details of that which is right. It is, I think, competent to the statutory majority of the shareholders to say that as to particular items of their business it is to the interest of the corporation that there shall be secrecy, and that the auditors, who must for the purposes of their audit, know all such details, shall not unless their duty under the statute requires it, disclose such details to the members. There is no suggestion in this case that these clauses are intended to be used for any other than a legitimate purpose. Those who are engaged in commerce are familiar with the fact that undue publicity as regards the details of their trade, or as to their financial arrangements, may often be very injurious to traders, having regard to the rivalry of competitors in trade, to complications sometimes arising from strained relations between capital and labour, and the like. These are legitimate reasons for ensuring secrecy to a proper extent. It is not, I think, necessary, nor having regard to the great utility of these Acts, is it desirable, to expose persons who trade under these Acts to the necessities of a publicity from which their competitors are free unless such publicity is required to ensure commercial integrity. I am not disposed to look too closely for reasons why I should find clauses such as these to be inconsistent with the Act if I see that the true purpose of the Act is satisfied. I think, however, these special resolutions go too far. Any regulations which preclude the auditors from availing themselves of all the information to which under the Act they are entitled as material for the report which under the Act they are to make as to the true and correct state of the company's affairs, are, I think, inconsistent with the Act."

The ethics of creating secret reserve is no doubt a subject of considerable discussion and difference of opinion. So long as wrong advantage is not taken of such reserves as was the case in *Kelner's* criminal trial it has always been held that the creation of such a secret reserve within reasonable limits is most desirable, particularly in connection with financial concerns, such as banks, etc. Generally speaking, whether one desires to create a secret reserve or not in case of all companies whose assets are prudently valued and depreciated, the values as appearing on the balance-sheet would be at the best estimated and that too at a valuation lower than their market value. Thus virtually speaking in any such concern prudently managed, there will be a secret reserve in one form or the other. Again in case of what are called speculative business, a secret reserve tends to maintain dividends at a normal level. The one objection is that if secret reserve is created in excess, the result would be that the market quotation for company's shares may be much lower to the detriment of shareholders and this might have been created by the directors intentionally and in some cases fraudulently. To take an illustration, supposing abnormal secret reserves are created and lower dividends are paid by which the market gets depressed during one year and thereafter the directors who have the internal knowledge buy in large quantity of these shares at low value and thereafter raise the value of the shares during subsequent year by bringing into account these profits that would be a very detrimental to the shareholders concerned. Of course, it is the duty of the auditor in such cases to bring out this fact in his report as soon as he discovers this type of manipulation.

According to Prof. Dicksee in his excellent book on Auditing (13th edition), page 250, the greatest objection to the creation of secret reserve would be on the ground that it may be created with a view to secure command of moneys that may be expended without being accounted for. Thus according to the learned author the reserve might conceivably be employed :—

"(1) In securing control of allied undertakings upon the American Trust principle, in which case the value of the 'investments' may be quite speculative; (2) in investments in, or loans to, undertakings in which the directors are personally interested, in which case the application may not be at all in the interests of the company; (3) in commissions or bribes to the agents of customers and others. *i.e.*, in ways declared illegal by the Prevention of Corruption Act, 1906; (4) in voting 'additional remuneration' to the directors or their friends. It is clear from the decision in the *Birmingham Small Arms Case* that the duty is cast upon the auditor of reporting to the shareholders in all cases where he considers that the assets representing the secret reserve have been misapplied; his position in this respect is thus one of the gravest responsibility."

The question of secret reserve and the power of the company to create same will remain in doubt until a final and authoritative decision is given by the highest tribunal because *Newton* v. *Birmingham Small Arms Case*, (1906) 2 *Ch.* 378 cited above, is at present the only case dealing on the subject. As the other cases stand the position is that the question of the value at which the assets should be shown on the balance-sheet and accounts will be a purely domestic question (*Spanish Prospecting Co.*, (1911) 1 *Ch.* 92; *Young* v. *Brownlee & Co.*, (1911) *S. C.* 677). Even though our Form F fixes down the capital assets to be shown at original cost less depreciation under each head, there is nothing to prevent the assets being over depreciated even here with a view to create a secret reserve indirectly.

Dividend Equalization Reserve

There is one form of reserve fund which remains to be mentioned and that is a reserve frequently created by joint stock companies and called "dividend equalization reserve." The object here is that where the profits of a company vary considerably from year to year, a fund is created to enable the company to pay uniform dividends. Thus during the prosperous years such a reserve may be created and utilised for payment of dividends during lean years, thereby maintaining a uniform level of dividends from year to year. This of course not only has the merit

of giving the shareholders a uniform dividend, but also of maintaining a capital value of his investment on the market which would otherwise fluctuate with the larger or smaller dividend paid from time to time. The general opinion from a business standpoint happens to be that in this case the reserve should be invested in outside securities of a reliable nature, because the reserve has to be drawn upon during the period of depression, when if the amount were to be invested in the business itself, the company would find itself more embarrassed than ever.

BALANCE-SHEET

We have already seen in the beginning of this chapter that every joint stock company except a private company has to prepare a balance-sheet, *and a profit and loss account which must be audited and copies of all these should be sent to every member to his registered address at least fourteen* days before the meeting at which it has to be laid before the members. The auditor's report may be either attached to the balance-sheet or may be made out separately. In case it is made out on a separate paper, reference as to this report must be made on the balance-sheet. It is however, considered more desirable that the report should be attached with the balance-sheet, and should be written at the foot of it, provided it is not likely to be a lengthy one. This course is generally followed. This report has to be read before the shareholders in general meeting, irrespective of whether the same is published with the balance-sheet. For this purpose the form marked " F " in the Third Schedule of the Act has to be followed. The figures as shown in the balance-sheet do not as a rule indicate the exact position of the company. The same is more or less an approximation. This is particularly so in case of fixed assets. Their values as appearing in the balance-sheet may indicate book balances at cost, minus depreciation, whereas the market value may have varied considerably since they were purchased. On the other hand, the fixed assets may have been revalued for the purpose of the balance-sheet.

All that is wanted in law is that the position of the company as shown by the balance-sheet is not exaggerated, *i.e.*, shown actually better than what it happens to be (*Newton* v. *Birmingham Small Arms Co., Ltd.*, (1906) 2 *Ch. D.* 378 *at p.* 387). Thus, the directors can even value the stock at much lower value than what it actually represents, but they should not show it at a higher figure. If however this financial position is made to appear bad with a view to enable the directors and managing agents to buy in shares cheap from shareholders, that would be highly objectionable. In case any commission is paid on the issue of the shares the same should also be shown on the balance-sheet until it is written off. When the assets are shown at a valuation, the mode of valuation should also be indicated.

The Form F as substituted by the Amendment Act of 1936 given at the end of the Companies Act is to be followed in India as far as possible by all companies registered under the Indian Companies Act, 1913. This form will be found in Vol. II, Appendix C along with the Act. Instead of giving a list of new alterations the old Form F was substituted by an entirely redrafted form " so that it shall itself present the complete form." The alterations made influenced by a desire according to the select committee " to improve the form from an accountancy point of view." A private company of course is not required to file a copy of its balance-sheet with the registrar (Sec. 134 (3)). Every member of a company (including a private company) is entitled to be furnished with the copies of balance-sheets *the profit and loss account or the income and expenditure account* and the auditor's report on payment of a charge not exceeding annas six for every hundred words (Sec. 135). The preference shareholders and the debenture-holders, except in case of a private company or a company registered before 1st April, 1914, have also the right to receive and inspect the balance-sheet of the company and the report of the auditors on the same footing as ordinary shareholders. *In case of a public company*

the trustees for the debenture-holders shall have the same right (Sec. 146).

False or Misleading Balance-Sheet

It should be remembered that under Sec. 282 of the Indian Companies Act, whoever makes a false balance-sheet or return, report, certificate or other document required for the purpose of this Act in any material particular knowing it to be false, is punishable with imprisonment of either description for a term which may extend to three years and shall also be liable to fine. An offence under this section may also be an offence under the Indian Penal Code (*Queen* v. *Moss,* (1894) 16 *All.* 88). It has also been held that a misleading declaration under Sec. 103 (1) (*c*) to enable a company to commence business is also within this section (*Emperor* v. *Bose,* (1924) 46 *All.* 218). As to criminal prosecution of directors and other officers guilty of issuing fraudulent balance-sheets, accounts etc., it has been held by *Buckley, J.*, in *London & Globe Finance Corporation,* (1903) 1 *Ch.* 728 that the Court on its own motion should institute criminal proceedings on the ground that a *prima facie* case was shown whenever the Court thinks that it is the duty of a good citizen to institute criminal proceedings and in that case the Court would be within its powers to order the liquidator to do so at the expense of the company. *Under the Indian Companies (Amendment) Act,* 1936 *a specific power is now given under Sec.* 237 *to the Court to order prosecution either on its own motion or if information is placed before it by the liquidator in case of liquidation by the order of the Court or under its supervision or in case of voluntary liquidation.*

The Position of Form "F" at Law

All Indian companies are required by the Act to prepare the balance-sheet according to Form "F" or as near thereto as circumstances admit [Sec. 132 (2)]. In this connection the most interesting case is

that of (*P. D. Shamdasani* v. *Pochkhanawala,* (1927) 29 *Bom. L. R.* 722). Here it was laid down that Form F as given must be strictly followed and that in connection with consideration of a balance-sheet of Indian companies, the English Law must be applied with great caution. In this case a banking company in India, while preparing its balance-sheet according to Form "F" Schedule III to the Indian Companies Act of 1913, was required to show under the item of "book debts" on the "properties and assets side" bad and doubtful or bad debts appearing in its books of accounts. The company cut down the debts so as to eliminate or reduce a reference to this bad and doubtful debts in the balance-sheet and the Court held that it was not under the Form at liberty to do so. The book debts were defined in this case as meaning all debts which were temporarily debts owing to the company and were so shown in the books of the company. It was further laid down that a debt is none the less a debt though there may be little prospect of its recovery and though the creditor may have the means of recovering the deficit if it is not paid. Of course since the company wrote off the debt on their being entirely irrecoverable, the debt ceases to be book debt. Soon after this decision was given, Form "F" was altered (Government Gazettee Extraordinary dated 31st March 1927).

FOREIGN COMPANIES BALANCE-SHEETS AND DOCUMENTS

In case of foreign companies, *i.e.*, companies established outside British India, Sec. 277 lays down that every such company in every year shall file with the registrar of the province in which the company has its principal place of business a balance-sheet in the form required by the law for the time being in force in the country where it was incorporated in case the said law requires the company to file an annual balance-sheet with the public authority, *and if the balance-sheet does not contain all the information*

provided for in the form marked H in the Third Schedule, such supplementary statements as shall furnish such information. In a case when no such provision is made by the law of the country in which the company is incorporated such a statement in the form of a balance-sheet as such company would, if it were formed and registered under the Indian Act be required to file. This section affects companies incorporated outside British India which have a place of business in British India but do not affect those who do business only through agents or correspondence from abroad. It has been held that carrying business through an agent or agents is not establishing business within the section (*Ballie* v. *Goodwyn & Co.*, (1886) 33 *Ch. D.* 604; *Grant* v. *Anderson & Co.*, (1892) 1 *Q. B. D.* 108; *Huron* v. *Erie Loan Co.*, (1911) *S. C.* 612). In case of a foreign company which has places of business in more than one centres within British India they have to file documents as required in this section with registrar of each province in which the business happens to be situate.

The foreign company which happens to be a private company is not required to file a copy of the balance-sheet under this section. It has been held that persons who are authorised under this section to accept process or notices on the company, cannot remove their names from the file or disclaim their position as representatives of the companies concerned with a view to affect the position of creditors (*Sedgwick, Collins & Co.* v. *Rossia Insurance Co.*, (1926) 1 *K. B.* 1; *Sabatier* v. *Trading Co.*, (1927) 1 *Ch.* 495 *W. N.* 21). For the exact wording of Sec. 277 Appendix C may be referred to where the Act has been appended.

The documents which a foreign company which establishes a place of business within British India must file within one month from the establishment of such place of business are the following:—

(1) A certified copy of the charter, statute or memorandum and articles of the company, or other instruments constituting or defining the constitution of the company.

If this document is not prepared in English, a translation in English must also be filed.

(2) The full address of registered or principal office of the company.

(3) A list of directors and managers of the company, if any.

(4) Names and addresses of someone or more persons resident in British India authorised to accept on behalf of the company service of process and notices required to be served on the company. In case of alternations in any of the above the company shall within prescribed time file with the registrar a notice of alteration. A process or notice shall be sufficiently served on the company if addressed to a person whose name has been so filed under the section and is left or sent by post to the said address.

The regulations as to the use of the word limited in case of limited company also apply to foreign companies as well as the affixing of boards outside the place of business where it carries on business in British India. Every prospectus inviting subscriptions for its shares and debentures in British India issued by a foreign company must state the country in which the company is incorporated and the name of the said company together with the country in which it is incorporated in legible characters in all bill heads and letter-paper and in all notices, advertisements and other official publications of the company, failure to comply with any of the requirements of the section entails a fine on every officer or agent of the company not exceeding Rs. 500 or in case of a continuing offence Rs. 50 for every day during which the default continues. *The Amendment Act of 1936 does away with the discretion which the old Act gave to the Governor-General in Council to exempt foreign companies from complying with the provisions of S. 277.*

Sale and Offer for Sale of Shares

It is not lawful for any person to issue, circulate or distribute in British India any Prospectus offering for

subscription shares in, or debentures of a company incorporated or to be incorporated outside British India, whether the company has or has not established, or when formed, will or will not establish, a place of business in British India, unless in compliance with the following requirements :—

(i) before the issue, circulation or distribution of the prospectus in British India, a copy of same certified by the chairman and two other directors of the company as having been approved by resolution of the managing body, has been handed for registration to the registrar;

(ii) the prospectus states on the face of it that the copy has been so delivered;

(iii) the prospectus is dated; and

(iv) the prospectus otherwise complies with Part X of the Indian Companies Act, relating to companies established outside British India, or issues to any person in British India a form of application for shares in or debentures of such company or intended company, unless the form is issued with the prospectus which complies with the requirements of Part X. However, this provision will not apply if it is shown that the form of application was issued in connection with a bona fide invitation to a person to enter into a underwriting agreement with respect to the shares or debentures [277A (1)].

The above regulations will not apply to the issue to existing members or debenture holders of a company of a prospectus or form of application relating to shares in or debentures of the company, whether an applicant for shares or debentures, will or will not have the right to renounce in favour of other persons, but subject as aforesaid, this regulation will apply to a prospectus or form of application whether issued on or with reference to the forms of a company or subsequently. [Sec. 277A (2)]. It is further laid down that any document by which any shares in or debentures of a company incorporated outside British India are offered for sale to the public, the same would, if the company was a company within the meaning of the Indian Companies Act, have been deemed by virtue of Section 98A to be a

prospectus issued by the company, that document will be deemed to be, for the purpose of Section 277A, a prospectus issued by the company [277A (3)]. If, however, an offer of sales of shares or debentures for subscription or sale is made to any person whose ordinary business or part of whose ordinary business it is to buy or sell shares or debentures, whether as principal or agent, shall not be deemed an offer to the public for the purposes of Section 277A. A fine not exceeding rupees five thousand is imposed on any person who is knowingly responsible for the issue, circulation or distribution of any prospectus or for the issue of a form of application for shares or debentures in contravention of these provisions. [277A (4 and 5)].

Requirements as to Prospectus

In order to comply with Part X of the Act dealing with companies incorporated outside British India, a prospectus in addition to complying with the provisions of Section 277A (ii) and (iii) of clause (a) must contain particulars with respect to the following matters :—

(i) the objects of the company;

(ii) the instrument constituting or defining the constitution of the company.

(iii) the enactments, or provisions having the force of an enactment, by or under which the incorporation of the company was effected;

(iv) an address in British India where the said instrument, enactments or provisions, or copies thereof, and if the same are in a foreign language a translation thereof in the English language certified in the prescribed manner, can be inspected;

(v) the date on which and the country in which the company was incorporated;

(vi) whether the company has established a place of business in British India and, if so, the address of its principal office in British India.

The provisions (i), (ii) and (iii) will not apply in the case of a prospectus issued more than two years after the date at which the company is entitled to commence business. The company has also to state the matter specified

in Sec. 93 (1A) subject to the above mentioned provisions, and set out the reports specified in that section. If, however, any prospectus is published as a newspaper advertisement, it shall be a sufficient compliance with the requirement that the prospectus must specify the objects of the company if the advertisement specifies the primary object with which the company was formed and only a reference to the articles of the company shall be deemed to be sufficient reference to the constitution of the company (Sec. 277B). Any condition which requires or binds any applicant for shares or debentures to waive compliance with any requirement of this Section, or which purports to affect him with notice of any contract, document or matter not specifically referred to in the prospectus, shall be void [Sec. 277B (ii)]. Where any of the requirements of Sec. 277B are contravened a director or other person responsible for the prospectus shall not incur any liability by reason of the non-compliance or contravention if

(i) as regards any matter not disclosed, he proves that he was not cognisant thereof, or

(ii) he proves that the non-compliance or contravention arose from an honest mistake of fact on his part, or

(iii) that the non-compliance or contravention was in respect of matters which, in the opinion of the Court dealing with the case, were immaterial or were otherwise such as ought, in the opinion of that Court, having regard to all the circumstances of the case, reasonably to be excused.

However, in case of failure to include in a prospectus a statement with respect to the matters specified in Section 93 (i) clause (n), no director or other person shall incur any liability in respect of the failure, unless it is proved that he had knowledge of the matter not disclosed [S. 277B (iii)]. Nothing contained in Sec. 277B shall limit or diminish any liability which any person may incur under the general Law or under this Act, apart from the section.

Canvassing for Sale of Shares

It is now laid down that it shall not be lawful for any person to go from house to house offering shares of a

company incorporated outside India for subscription or purchase to the public or any member of the public. The expression " house " shall not include an office used for business purposes. Any contravention of this requirement would render the person concerned liable to a fine not exceeding rupees one hundred. (Sec. 277C).

Registration of Charges

The provisions of Sections 109 to 117, both inclusive, and Sections 120 to 125, shall extend to charges on properties in British India which are created and to charges on property in British India which is acquired after the commencement of the Indian Companies (Amendment) Act, 1936 by a company incorporated outside British India which has an established place of business in British India. (Sec. 277D).

Appointment of Receiver

The provisions of Sections 118 and 119 shall apply mutatis mutandis to the case of all companies incorporated outside British India but having an established place of business in British India and the provisions of Section 130 shall apply to such companies to the extent of requiring them to keep at their principal place of business in British India the books of account required by that section with respect to money received and expended, sales and purchases made, and assets and liabilities in relation to its business in British India (Sec. 277E).

Articles dealing on dividends, reserves and accounts as given in Table A and as distinguished with the forms in use in India by Indian companies

DIVIDEND AND RESERVE

Table A—Clause 95 :—The company in general meeting may declare dividends, but no dividends shall exceed the amount recommended by the directors.

63

NOTE :—The above is a very simple form *and Sec. 17 (2) makes this regulation or an identical regulation as this compulsory* but in Indian companies various forms are in use such as the following :—

"Subject as aforesaid, the profits of the company shall be divisible among the members in proportion to the capital paid up on the shares held by them respectively."

"Where capital is paid up in advance of calls upon the footing that the same shall carry interest, such capital shall not, whilst carrying interest, confer a right to participate in profits."

"The company in general meeting may declare a dividend to be paid to the members according to their rights and interests in the profits, and may fix the time for payment."

"The declaration of the directors as to the amount of the net profits of the company shall be conclusive."

Another alternative form, particularly where preference shares are in contemplation is as follows :—

"Subject to the rights of holders of preference shares, if any, and to any resolution of the company attaching any special privileges to other shares and the provisions of these articles the net profits of the company (after making provision, if any, for sinking, depreciation, reserve or other funds and for carrying out balance for the next year) shall be divisible among the members in proportion to the capital paid up or credited as paid up on the shares held by them respectively."

Table A—Clause 96 :—The directors may from time to time pay to the members such interim dividends as appear to the directors to be justified by the profits of the company.

NOTE :—A clause similar to the above is used by Indian companies with a slight verbal difference as follows in connection with interim dividend :—

"The directors may from time to time pay to the members such interim dividends as in their judgment the position of the company justified."

Table A—Clause 97 :—No dividends shall be paid otherwise than out of profits *of the year or any other undistributed profits.*

NOTE :—The above clause is used bodily as we saw in connection with notes on Table A—Clause 95 above. *It is also a clause which or an identical clause to it which Sec. 17 (2) makes compulsory.*

Table A—Clause 98 :—Subject to the rights of persons (if any) entitled to shares with special rights as to dividends, all dividends shall be declared and paid according to the amounts paid on the shares but if and so long as nothing is paid upon any of the shares in the company, dividends may be declared and paid according to the amounts of the shares. No amount paid on a share in advance of calls shall, while carrying interest, be treated for the purposes of this article as paid on the share.

NOTE :—The Indian companies utilise the spirit of the above clause in a different wording. With regard to dividend being payable only on the paid-up value of the share, we have already seen a clause given above in connection with Clause 95 of Table A. With reference to calls paid in advance, the form in use by Indian companies is as follows :—

"Where capital is paid up in advance of calls, upon the footing that the same shall carry interest such capital shall not, whilst carrying interest, confer a right to participate in profits."

Table A—Clause 99 :—The directors may, before recommending any dividend, set aside out of the profits of the company such sums as they think proper as a reserve or reserves which shall, at the discretion of the directors, be applicable for meeting contingencies, or for equalizing dividends, or for any other purpose to which the profits of the company may be properly applied, and pending such application may, at the like discretion, either be employed in the business of the company or be invested in such investments (other than shares of the company) as the directors may from time to time think fit.

NOTE :—A clause similar to the above, but in a little more detailed and elaborate form is used by our Indian companies but one most universal is as follows :—

"Before recommending any dividend, to set aside out of the profits of the company such sums as they think proper as a Sinking Fund, Depreciation Fund or Reserve Fund to meet contingencies or for liquidation of debts and liabilities of the company or for equalisation of dividends or for special dividends or for repairing, improving and maintaining any of the property of the company and for such other purposes as the directors shall in their absolute discretion think conducive to the interests of the company, and to invest the several sums so set aside upon such investments (other than shares of the company) as they may think fit, and from time to time deal with and vary such investments, and dispose of all or any part thereof for the

benefit of the company and to divide the reserve fund into such special funds as they think fit with full power to employ the assets constituting the reserve fund in the business of the company, and that without being bound to keep the same separate from the other assets."

Table A—Clause 100 :—If several persons are registered as joint-holders of any share, any one of them may give effectual receipts for any dividend payable on the share.

NOTE :—A similar clause as above is used by our Indian companies, but in a different wording such as the following :—

"Any one of several persons who are registered as the joint-holders of any share or the manager of any member's business may give effectual receipts for all dividends and payments on account of dividends in respect of such share; provided that the managing agents may in their discretion refuse to pay any money or deliver any property by way of dividend to any person other than the member personally."

Table A—Clause 101 :—Notice of any dividend that may have been declared shall be given in manner hereinafter mentioned to the persons entitled to share therein.

NOTE :—Some companies keep the exact wording of the above clause in Table A and others omit it because generally the arrangement is to send dividend by post. Where this clause is used in Indian companies, it takes the following form :—

"Notice of the declaration of any dividend, whether interim or otherwise, shall be given to the holders of registered shares in manner hereinafter provided."

The other alternative form or dividend or bonus is as follows :—

"Notice of any dividend or bonus that may have been declared shall be given to the shareholders either by advertisement in at least one English and one vernacular paper published in Bombay or by writing sent to the registered address of the shareholders through the post or by a messenger.

Table A—Clause 102 :—No dividend shall bear interest against the company.

NOTE :—The above wording is either bodily incorporated in one of the clauses of the articles as given above by Indian companies or separately stated.

Additional clauses :—Besides the above clauses as in-dicated above; articles of association of all our Indian companies contain many additional clauses which are most convenient and necessary in connection with daily practice of the company. They are as follows :—

For reduction of debts

"The directors may retain any dividends on which the company has a lien, and may apply the same in or towards satisfaction of the debts, liabilities or engagements in respect of which the lien exists."

An alternative clause is as follows :—

"The directors may deduct from the dividends or bonus payable to any shareholder in the company all such sums of money as may be due from him to the company on account of any calls, interest due thereon, and expenses incurred in respect of the same, or on account of any other matter of whatsoever nature."

There is a further clause providing for a dividend being declared simultaneously with the making of calls and making it payable at the same time as the dividend. It runs as follows :—

"Any general meeting declaring a dividend may make a call on the members of such amount as the meeting fixes, but so that the call on each member shall not exceed the dividend payable to him, and so that the call be made payable at the same time as the dividend and the dividend may if so arranged between the company and the member, be set off against the call. The making of a call under this clause shall be deemed ordinary business of an ordinary general meeting which declares a dividend."

The above is also a very convenient power to take in the articles.

The other most useful power which every Indian joint stock company's articles embrace is the power to pay dividend in specie. This article runs more or less in the following form :—

"Any general meeting sanctioning or declaring a dividend may direct payment of such dividend wholly or in part by the

distribution of specific assets, and in particular of paid up shares, debentures or debenture-stock of the company or of any other company, or in any one or more of such ways and the directors shall give effect to such resolution and where any difficulty arises in regard to the distribution, they may settle the same as they think expedient, and in particular may issue fractional certificates and may fix the value for distribution of such specific assets, or any part thereof, and may determine that cash payment shall be made to any members upon the footing of the value so fixed in order to adjust the rights of all parties, and may vest any such specific assets in Trustees upon such trusts for the persons entitled to the dividend as may seem expedient to the directors. Where requisite, a proper contract shall be filed in accordance with Section 104 of the Indian Companies Act, 1913, and the directors may appoint any person to sign such contract on behalf of the persons entitled to the dividend, and such appointment shall be effective."

In case of death or bankruptcy of a member the following clause in connection with dividend known as 'retention clause,' which gives power to the company to retain the dividend until the person to whom the shares are transmitted in law either becomes a member or duly transfers the shares to somebody else, is used. This is a clause which indirectly forces an executor or trustee to get the shares transferred on his own name and may be or may not be a desirable clause to incorporate in the articles of our companies. As it is used in some companies the form is given as below:—

"The directors may retain the dividends payable upon the shares in respect of which any person is under the transmission clause entitled to become a member, or which any person under that clause is entitled to transfer, until such person shall become a member in respect thereof or shall duly transfer the same."

The usual practice of Indian companies is to pay dividend through post and varying forms are used in connection therewith. The form in general use is as follows:—

"Unless otherwise directed, any dividend may be paid by cheque or warrant sent through the post to the registered address of the member entitled or that member whose name stands first on the register in respect of the joint holding and every cheque or warrant so sent shall be made payable to the order of the person to whom it is sent."

In order to make the position of the company safe in connection with the loss of these cheques for dividend through transmissions, the following wording is added in some cases which is the most desirable wording in the interest of the company itself :—

"The company shall not be liable or responsible for any cheque or warrant lost in transmission or for any dividend lost to the member or person entitled thereto by forged endorsement of any cheque or warrant or fraudulent recovery thereof by any other means."

The other additional clause will be found in case of Indian companies as one providing for the disposal of unclaimed dividends after a certain time has expired. This clause runs as follows :—

"All dividends unclaimed for one year after having been declared may be invested or otherwise made use of by the directors for the benefit of the company until claimed and all dividends unclaimed for three years after having been declared may at the end of that period be forfeited by the directors for the benefit of the company and cease to be payable and may be added to the reserve fund, but the directors may remit the same whenever they think proper."

It will be noticed that in the above clause three years are provided for though according to Limitation Act in absence of such an article, the shareholder concerned would be entitled to get his dividend within six years of its being declared. If the same clause is to apply to bonus also the word "bonus" may be added to the word dividends as is done in case of some companies. A further clause providing for the transfer affected at the time of declaration of dividend runs as follows :—

"A transfer of shares shall not pass the right to any dividend declared thereon before the registration of the transfer."

ACCOUNTS

Table A—Clause 103 :—The directors shall cause true accounts to be kept.

(*a*) of the sums of money received and expended by the company, and the matter in respect of which such receipt and expenditure takes place; and

(b) all sales and purchases of goods by the company;
(c) of the assets and liabilities of the company.

NOTE :—The Indian companies have incorporated a similar Article on more or less similar terms. The usual form is as follows :—

"The Secretaries, Treasurers and Agents shall cause proper books of accounts to be kept of the paid up capital for the time being of the company, and of all sums of money received or expended by the company and of the matters in respect of which such receipt or expenditure takes place, of all sales and purchases of goods by the company, and of the credits and liabilities of the company, and generally of all its commercial, financial and other affairs, transactions, and engagements, and of all other matters necessary for showing the true financial state and condition of the company, and the accounts shall be kept in such books and in such manner as the directors may deem expedient."

Frequently a line is added to the effect that "and the director shall be entitled to examine and inspect the said accounts."

Table A—Clause 104 :—The books of account shall be kept at the registered office of the company, or at such other place as the directors shall think fit, and shall be open to inspection by the directors *during business hours.*

NOTE :—Most of the Indian companies bodily incorporate the above clause.

Table A—Clause 105 :—The directors shall from time to time determine whether and to what extent and at what times and places and under what conditions or regulations the accounts and books of the company or any of them shall be open to the inspection of members not being directors, and no member (not being a director) shall have any right of inspecting any account or book or document of the company except as conferred by law or authorised by the directors or by the company in general meeting.

NOTE :—The above clause is also bodily incorporated in most of the Indian companies articles of association. In some companies the last line, *viz.*, "or by a resolution of the company in general meeting" is omitted which omission is most undesirable as it deprives the shareholders of their right to decide upon inspection in a general meeting if they wish the accounts to be inspected under certain exceptional circumstances by experts appointed by them.

Table A—Clause 106 :—The directors shall as required by Ss. 131 and 131A of the Indian Companies Act, 1913, cause to be prepared and to be laid before the company in general meeting such profit and loss accounts, balance sheets and reports as are referred to in these sections.

NOTE :—The usual clause on the above point in case of Indian companies takes the following form :—

"At an ordinary general meeting the directors shall lay before the company yearly profit and loss account and balance sheet containing a summary of the assets and liabilities of the company made up to a date not more than four months before the meeting, from the time when the last preceding account and balance sheet were made up, or in the case of the first account and balance sheet from the incorporation of the company *and the directors' report with respect to the state of the company's affairs, the amount if any which they recommend should be paid by way of dividend and the amount if any which they propose to take to the reserve fund, general reserve or reserve account.*"

Table A—Clause 107 :—The profit and loss account shall *in addition to the matters referred to in sub-section (3) of Sec. 132 of the Indian Companies Act, 1913,* show arranged under the most convenient heads, the amount of gross income, distinguishing the several sources from which it has been derived, and the amount of gross expenditure, distinguishing the expenses of the establishment, salaries and other like matters. Every item of expenditure fairly chargeable against the year's income shall be brought into account, so that just balance of profit and loss may be laid before the meeting, and, in cases where any item of expenditure which may in fairness be distributed over several years has been incurred in any one year, the whole amount of such item shall be stated, with the addition of the reasons why only a portion of such expenditure is charged against the income of the year.

NOTE :—Most of the Indian companies omit the above clause. Some have an article similar to the above clause. It is most desirable that they should voluntarily submit their profit and loss account in proper form as laid down and suggested by the above Table A Article. Some companies however in the balance sheet clause which follows later, samples of which we are dealing with in connection with Clause 108 of Table A hereunder, deal with this point in more or less the following form :—

"Once at least in every year the directors shall lay before the company in general meeting a balance sheet and a profit and

loss account of the company, made up to the 31st day of December then last past showing in detail the total income and the total expenditure, and such statements shall be accompanied by the reports of the directors, and printed copies of the balance sheet and profit and loss account shall be forwarded to the shareholders at their respective registered addresses through the post, at least seven days before the ordinary general meeting."

NOTE :—It will be noticed that in the above clause the wording used is "and a profit and loss account of the company made up to the 31st day of December then last passed showing in detail the total income and the total expenditure," where an attempt is made to provide for a detailed profit and loss account showing under separate headings the different sources of income and expenditure as suggested by clause 107 above.

Table A—Clauses 108 & 109 :—A balance sheet shall be made out in every year and laid before the company in general meeting made up to a date not more than six months before such meeting. The balance sheet shall be accompanied by a report of the directors as to the state of the company's affairs and the amount which they recommend to be paid by way of dividend, and the amount (if any) which they propose to carry to a reserve fund.

A copy of the balance sheet and report shall, seven days previously to the meeting, be sent to the persons entitled to receive notices of general meetings in the manner in which notices are to be given hereunder.

NOTE :—The usual form of article in case of Indian companies embraces both the two above articles together and runs in more or less the following form :—

"Every such balance sheet shall be accompanied by a report of the directors as to the state and condition of the company and as to the amount which they recommend to be paid out of the profits by way of dividend or bonus to the members and the amount (if any) which they propose to carry to the Reserve Fund, Sinking and Depreciation Fund or any other Special Fund according to the provisions in that behalf hereinbefore contained and the account, balance sheet and report shall be signed by two directors and countersigned by the managing agents."

"A printed copy of such account, balance-sheet and report shall, seven days previously to the meeting be served on the registered holders of shares in the manner in which notices are hereinafter directed to be served."

Where there are no Managing Agents, the first of the

above clauses in the Indian companies would contain instead of the words "and countersigned by the managing agents," the word such as "and countersigned by such officer of the company as usually from time to time be authorised by the directors for the purpose."

Where half-yearly accounts are also contemplated to be sent, an article is added to the following effect in the Indian companies articles of association :—

"The directors may, in addition to the annual account before mentioned, make up a half-yearly account, and forward to the shareholders, printed copies of the same without calling a general meeting."

Table A—Clause 110 :—The directors shall in all respects comply with the provisions of Secs. 130 to 135 of the Indian Companies Act, 1913, or any statutory modification thereof for the time being in force.

NOTE :—The above clause is never to be found in the Indian companies articles of association.

CHAPTER XVII

Audit and Auditors

General remarks

Company Law requires a company to appoint at each annual general meeting, an auditor, to hold office until the next annual general meeting, failing which, the Local Government may, on the application of any member of the company, appoint an auditor of the company for the current year and fix the remuneration for his services to be paid to him by the company. In making such an appointment care should be taken to see that no person holding the office of a director or officer of the company, or that of partner of such a director or officer, and in case of companies other than a private company, no person in the employ of such a director or officer, is appointed. *Any person indebted to the company* also cannot be appointed auditor and *in case any person after being appointed auditor becomes indebted to the company his appointment shall be terminated* [S. 144 (5) (iv)]. It is further provided by our Indian Companies Act that in case of a company other than a private company, the auditor shall be a person holding a certificate from the Local Government entitling him to act as an auditor of companies, or is a member of any institution or association specified in the notification in the Gazette of India by the governor-general in council. Our Act here lays down a principle which places it a step forward in comparison to the English Companies Act where no specific qualification for auditors of public companies is insisted upon. It is further laid down that, the continuing auditor can only be removed at a subsequent meeting in case the person who proposes to appoint some other person in the office of auditors gives a notice to the company to that effect of at least not less than fourteen days before the date

of the annual general meeting. A copy of such a notice should be sent by the company to the retiring auditor, and it must also inform its members as to this notice either by advertisement, or by any other method allowed by the Company's Act not less than seven days before the annual general meeting. The first auditors may be appointed by the directors before the statutory meeting and they shall hold office until the first annual general meeting, unless previously removed by the members of the company in general meeting, in which case such members of that meeting may appoint new auditors. In case any casual vacancy in the office of auditors occurs, the same may be filled in by directors, and until such vacancy is filled in the surviving auditor, if any, may continue to act. The remuneration of the auditor is fixed by the company in general meeting, except in case of those appointed by the directors before the statutory meeting, or with a view to fill any casual vacancies in which case the said directors may fix their remuneration. (Sec. 144). The articles of association of a company generally provide rules as to the appointment of auditors. It will thus be noticed that auditors have to be appointed both in the case of private and public companies, with this difference that, in case of private companies, the auditor need not be a person possessing the requisite qualification. We have noticed above that Sec. 144 (6) insists on the notice being given to the retiring auditor or auditors who are to be replaced. This requirement was first introduced in the English Act of 1907, to prevent the directors from getting an inconveniently strict auditor replaced through the appointment of a nominee or friend. This provision as to this notice at least affords the auditor an opportunity to place his case before shareholders if he desires to do so. Of course, the Act does not give the auditor an express right to attend the meeting of the company, but the permission to do so is seldom refused when asked. This difficulty will not arise when the auditor is also a shareholder, as he can in that case be present at the meeting in his capacity of a shareholder, whereas, in ex-

treme cases he may have his case presented through members sympathetic towards him.

In this connection Sec. 144 and Sec. 145 of our Indian Companies Act are important. The former section deals with the qualification and appointment of auditors which we shall quote here as under :—

Sec. 144 :—(1) No person shall be appointed or act as an auditor of any company other than a private company *not being the subsidiary company of a public company* unless he holds a certificate from the Local Government entitling him to act as an auditor of companies;

"Provided that a firm whereof (all the partners practising in India) hold such certificates may be appointed by its firm-name to be auditor of a company, and may act in its firm-name;" and

"(2) The Governor-General in Council may, by notification in the Gazette of India and after previous publication, make rules providing for the grant, renewal or cancellation of such certificates and prescribing conditions and restrictions for such grant, renewal or cancellation;

Provided that nothing contained in such rules shall preclude any person from being granted a certificate merely by reason that he does not practise as a public accountant.

(2-A) In particular, and without prejudice to the generality of the foregoing power, such rules may—

(*a*) provide for the maintenance of a register of accountants entitled to apply for such certificates;

(*b*) prescribe the qualifications for enrolment on the register and the fees therefor;

(*c*) provide for the examination of candidates for enrolment, and prescribe the fees to be paid by examinees;

(*d*) prescribe the circumstance in which the name of any person may be removed from or restored to the register;

(*e*) provide for the establishment, constitution and procedure of an Indian Accountancy Board, consisting of persons representing the interests principally affected or having special knowledge of accountancy in India, to advise him on all matters of administration relating to accountancy, and to assist him in maintaining the standards of qualification and conduct of persons enrolled on the register; and

(*f*) provide for the establishment, constitution and procedure of local accountancy boards at such centres as the

Governor-General in Council may select, to advise him and the Indian accountancy board on any matter that may be referred to them.

(2-B) The holder of a certificate granted under this section shall be entitled to be appointed and act as an auditor of companies throughout British India."

(3) Every company shall at each annual general meeting appoint an auditor or auditors to hold office until the next annual general meeting.

(4) If an appointment of an auditor is not made at an annual general meeting, the Local Government may, on the application of any member of the company, appoint an auditor of the company for the current year, and fix the remuneration to be paid to him by the company for his services.

(5) The following persons; that is to say :—

(*i*) a director or officer of the company; and

(*ii*) a partner of such director or officer, and

(*iii*) in the case of a company other than a private company *not being the subsidiary company of a public company* any person in the employment of such director or officer; and

(*iv*) *any person indebted to the company;* shall not be appointed auditors of the company; *if any person after being appointed auditor becomes indebted to the company his appointment shall thereupon be terminated.*

(6) A person, other than a retiring auditor, shall not be capable of being appointed auditor at an annual general meeting unless notice of an intention to nominate that person to the office of auditor has been given by a member of the company to the company not less than fourteen days before such annual general meeting, and the company shall send a copy of any such notice to the retiring auditor, and shall give notice thereof to its members either by advertisement or in any other mode allowed by the Articles not less than seven days before the annual general meeting :

Provided that, if after notice of the intention to nominate an auditor has been given to the company, an annual general meeting is called for a date fourteen days or less after the notice has been given, the requirements of this section as to time in respect of such a notice shall be deemed to have been satisfied, and the notice to be sent or given by the company may, instead of being sent or given within the time required by this section, be sent or given at the same time as the notice of the annual general meeting.

(7) The first auditors of the company may be appointed by the directors before the statutory meeting, and if so appointed shall hold office until the first annual general meeting unless pre-

viously removed by a resolution of the members of the company in general meeting, in which case such members at that meeting may appoint auditors.

(8) The directors may fill any casual vacancy in the office of auditor, but while any such vacancy continues, the surviving or continuing auditor or auditors (if any) may act.

(9) The remuneration of the auditors of a company shall be fixed by the company in general meeting, except that the remuneration of any auditors appointed before the statutory meeting, or to fill any casual vacancy, may be fixed by the directors.

It may be noticed that there is no specific provision for removal of auditors during the year but if directors exclude them on the ground of misconduct the court will not force the auditors on the company which the company disapproves (*Cuff* v. *London & County Land Co.*, (1912) 1 *Ch.* 440).

In connection with re-election of auditors, care should be taken to see that the proposal comes from the joint body of members or shareholders and not form the directors The remuneration of auditors is also fixed in the resolution which re-appoints them. With reference to the question whether a firm of accountants who have been employed by the directors of a company to keep accounts or assist in keeping up same for the company could also act as the company's auditors. There is no decided case but Prof. Dicksee, while dealing on this subject in his book on Auditing from which we have already quoted 13th edition, page 345, states as follows :—

"There are no decisions on the matter, but it is thought that where the appointment as book-keeper is a definite appointment of a more or less permanent nature, it would constitute the book-keeper an 'officer' of the company within the meaning of the Act, in just the same sense that the secretary is an officer; but instructions given exceptionally, or occasionally, to perform specified book-keeping work—*e.g.*, to help to overcome arrears in the writing up of the books—would, it is thought, not constitute the appointee an officer, in the same way that it has been ruled that the solicitor employed by a company to transact its legal business is not an officer. Whatever the legal position may be, however, it is clear that if the auditors are in the habit of receiving considerably larger fees from the directors in connection with the book-keeping

than they received *qua* auditors, the independence of their position is very seriously undermined; and that such an arrangement is altogether against the spirit of Sec. 144 (5). *A fortiori* must in this view be held in cases where the shareholders are in ignorance of the true facts of the position."

Sec. 144 (9) lays down that the remuneration of the auditors shall be fixed by the company in general meeting except that the remuneration of any auditors appointed before the statutory meeting or to fill up vacancies may be fixed by the directors. Here therefore generally the remuneration has to be fixed at the time of appointment by the shareholders or the shareholders may fix it at any subsequent time. If however, the shareholders have fixed the remuneration at the time of appointment, a contract between the company and the auditors is brought into existence which once the auditor has accepted office cannot be broken or varied by either parties without mutual consent.

With reference to Sec. 144 (7) where it is laid down that the first auditors of the company may be appointed by the directors before statutory meeting, the question arises as to what should happen if directors fail to exercise their right of appointment. The section does not give this right of appointment of auditors at this statutory meeting to the members of shareholders. The wording of Sec. 144 (4) also does not clear this difficulty because there the wording is that the local government may appoint auditors in case where his appointment is not made "at an annual general meeting." Of course there is no decided case on this subject to guide us for the simple reason that such difficulties have not arisen in practice owing to the universal appointment of first auditors by the directors themselves prior to the date of the statutory meeting. Where the auditors prepare the final accounts as well as report upon them, it is suggested that the accounts must be accepted by the directors first by being signed by them on behalf of the board before the auditors prepare their report on same in their capacity as auditors.

Number of Auditors

The number of auditors to be appointed depends on the provisions in the articles of the company concerned. Almost every company of importance employs at least two auditors. In case of companies having foreign branches, it is the practice to appoint local auditors for such foreign branches. Frequently, debenture-holders or some special class of shareholders are given the privilege to appoint separate auditors, *i.e.*, over and above those appointed by the company in general meeting on behalf of the general body of shareholders. When the articles of association of a company provide for the appointment of two auditors it will not be correct to appoint a firm of accountants made up of two or more partners, but two distinct firms or two members of two distinct firms will have to be appointed. Here the responsibilities of the joint auditors will be both joint and several, unless in the terms of the contract it is made clear that one auditor has to do a particular part of the audit and the other is to look after some other sphere. Frequently, auditors arrange among themselves to divide the work, one agreeing to check books of original record, and the other, finishing up the said audit by checking the work of final record and balance-sheet. This will not relieve anyone of them from responsibility for negligence of the other in connection with the work done by the other, as the responsibility is always presumed to be joint and the conditions of the appointment in themselves clearly imply that two men are appointed instead of one in order to ensure a double check. It is suggested in some quarters, particularly by *Mr. Spicer, Chartered Accountant,* in his book on "Practical Auditing," that in case of division of work by auditors by mutual agreement "it will be desirable for the auditor to avoid responsibility for the work he has not performed by specific statement in the report of the extent of the audit carried out by each." Whether this statement will actually exonerate an auditor who has been appointed to do the work jointly with another auditor,

and is paid his full remuneration on the supposition that he will take up the joint and several responsibilities for the complete audit, is a doubtful proposition.

Their Status

The exact legal status of the auditors is not finally established either by decisions or by the Act as far as their relation to the shareholders is concerned. They are no doubt appointed by the shareholders as their representatives to check the accounts on their behalf and report to them. They are thus in some sense agents of the shareholders to a limited extent. That was at least the view taken in *Nicol's Case,* (1858) 3 *De G. and J.* 387, but in a subsequent case *Spackman* v. *Evans,* (1868), *L. R.* 3 *H. L.* 171, it was further laid down that they were not agents in the sense that the knowledge of auditors is to be taken for granted as the knowledge of shareholders, as would be the case as per the Law of Agency where the notice to an agent is considered to be equivalent to a notice to the principal. Mr. Francis W. Pixley, one of the past presidents of the Institute of Chartered Accountants of England and Wales in his book on "Duties of Auditors" states as follows :—

> "The shareholders of a company may, therefore, be said to have two representatives of their interests, the one administrative, as represented by the directors, the other critical, in the person of the auditor. The latter is practically a check on the former, and frequently prevents the directors from acting impulsively or recklessly, they knowing that their transactions will ultimately be reviewed calmly and impartially by the auditor, who will communicate the result of his investigation and criticism to the shareholders to be acted upon by them as they may think proper at their meeting."

The auditor is also an officer of the company and would be liable like other officers for misfeasance according to the provisions of Secs. 235, 236 and 237 of the Act. The above three sections provide that where in course of winding up it appears that any person who has taken part in the formation or promotion of the company, or in the

past or present, as a director, manager or a liquidator or any officer of the company, and has misapplied or retained or become liable or accountable for any money or property of the company, or been guilty of misfeasance or breach of trust, in relation to the company, the Court may, on the application of the liquidator, or of any creditor or contributory *made within three years from the date of the first appointment of a liquidator in the winding up or of the misapplication, retainer, misfeasance or breach of trust, as the case may be,* whichever is longer, examine into the conduct of the promoter, director, manager, liquidator or officer and compel him to repay or restore the money or property or part thereof respectively with interest at the rate thought just by the Court, or to contribute such sum to the assets of the company by way of compensation as the Court thinks just. It may be however noted that accountants who are simply engaged by the directors to do some accountancy work do not come under the designation of auditors and therefore will not come under Sec. 236. It is further provided that any officer, manager, or director meaning and including auditor, who destroys, mutilates, alters, falsifies or secretes any books, papers or securities, or makes or is party to the making of, any false or fraudulent entries in any register, book of accounts or document belonging to the company with intent to defraud shall be liable to punishment (Sec. 236); and if it appears to the Court in the course of winding up by or subject to the supervision of the Court, that any past or present director, manager or other officer, or any member of the company has been guilty of any offence in relation to the company for which they are criminally liable the Court may either on the application of any person interested in the winding up or on its motion direct the liquidator either himself to prosecute or to refer the matter to the registrar (Sec. 237). It will be thus seen that our Company Act under S. 2 (11) auditors are declared to be officers for the purpose of Sections 235, 236 and 237, and besides that in Sec. 144 the words "every company shall at each annual general

meeting appoint an auditor or auditors to *hold office* until the next annual general meeting," are used.

Their Rights and Duties

The Indian Act lays down that every auditor of a company shall have a right of access at all times to the books, accounts and vouchers of the company. He shall be entitled to require from the directors and officers of the company such information and explanation as may be necessary for the performance of the duties of the auditors [Sec. 145 (1)]. As will be noticed these powers are very wide, because they not only empower the auditor to inspect books of accounts and vouchers of the company, but such an inspection can be claimed by him at any time, and that *too without being* required to give a prior notice. The books of accounts mean and include all financial books, plus statutory books, including the minute book or books of the company. In this connection it is interesting to note the case of *Hearts of Oak Assurance Co.* v. *Flower*, (1936) 1 *Ch. D.* 76, where *Barnnett, J.*, decline to admit in evidence a loose leaf minute book as a book. It is thus clear as far as the above judgment is concerned that a loose leaf book or accounts also cannot be regarded as books. The ground on which the learned judge came to this conclusion was that a loose leaf book " fastened in two covers in such a physical condition that at any moment, if any one wishes to do so he can take any number of leaves out and substitute any number of other leaves " was not a book that could " be used in evidence without the sanction of an oath as to its accuracy and without the party against whom the evidence is to be used being able to test its accuracy by cross-examination." On this point, *viz.*, the power of the auditor to inspect the books of accounts at any time there is one case in point, *viz.*, *Cuff* v. *London & County Land & Building Co. Ltd.*, (1912) 1 *Ch. D.* 440. Here the secretary of the company having been found guilty of defalcations by which loss was occasioned to the company, the directors accused the auditors of negligence and

refused to them the inspection of books of the company. The auditors brought an action with a view to enforce their right of inspection, which according to them being a statutory right could not be denied. *Eve, J.*, granted an order in favour of the auditors, but in the Court of Appeal this order was upset on the ground that this right of access to the books, though statutory, could only be enforced by a mandatory order of the Court, provided the Court in the exercise of its judicial discretion thought fit to grant the same under the circumstances of each particular case. In this case it was wrong to have given same without taking steps to ascertain whether, the company was desirous that the said auditors should continue to act as auditors, in spite of this charge of negligence against them. It is thus noticed, that the statutory right given by the Act can be enforced only through the intervention of the Court provided the Court in its judicial discretion grants the same after taking into consideration the circumstances of the case before it. With regard to the right to ask for explanations all that need be said is that, in case of refusal to give any explanation asked by auditors within their sphere of audit, the course left open to them is to insert that fact in their report to the shareholders.

The Act further lays down in connection with the auditors to the effect that, they shall make the report to the members of the company on the accounts examined by them, and on the balance-sheet *and profit and loss account* laid before the company in general meeting during his tenure of office. This report has to state, (1) whether or not they have obtained all the information and explanations they have required; (2) *whether or not in their opinion the balance-sheet and the profit and loss account referred to in the report are drawn up in conformity with the law;* (3) whether or not such balance-sheet exhibits a true and correct view of the state of the company's affairs according to the best of their information and explanations given to them and as shown by the books of the company; (4) *whether in their opinion books of accounts have been kept*

by the company as required by S. 130. It is further added that *where any of the matters referred to in* (1), (2), (3) *and* (4) *is answered in the negative or with a qualification the report shall state the reason for such answer* [S. 145 (2) (2A)]. In case of a banking company where the company has branch banks beyond the limits of India it is sufficient if the auditor is allowed access to such copies of and extracts from the books and accounts of any such branch as have been transmitted to the head office of the company in British India [S. 145 (3)]. Now the Amendment Act of 1936 lays down that *auditors shall be entitled to receive notice of and to attend any general meeting of the company at which any accounts which have been examined and reported on by them are to be laid before the company and may make any statement or explanation they desire with respect to the accounts* [S. 145 (4)]. *Where any auditor's report is made which does not comply with the requirements of the section, every auditor who is knowingly and wilfully a party to the default shall be punishable with fine which may extend to one hundred rupees* [S. 145 (5)]. It has been held that an auditor's certificate if founded on a wrong principle of law will not be binding (*Johnston* v. *Chestergate Hat Manufacturing Co.*, (1915) 2 *Ch.* 338; *Thomas* v. *Hamlyn & Co.*, (1917) 1 *K. B.* 527).

This right of auditors, or rather their duty, is one which cannot be altered, nor can any limitations be placed on them through cleverly devised clauses in the articles of association compelling auditors not to disclose certain facts in their reports as that would be inconsistent with the obligations imposed on the auditors by the Act (*Newton* v. *Birmingham Small Arms Co.*, (1906) 2 *Ch. D.* 378). The auditor has to report to the shareholders whether in his opinion the balance-sheet is correct according to the best of his information and explanations given to him. He does not certify the balance-sheet as is frequently erroneously asserted. This report has to be made by him after having carefully examined the books of accounts of the company, because he has to state in his report that

the balance-sheet which he has examined, and on which he reports, is correct as shown by the books of the company. It thus follows that if the books of the company are not accurately kept, the auditor should mention the fact in the report, but in case of inaccuracies of a character which the auditor cannot, with the use of ordinary diligence, discover, say omission of certain items of business from the books which could not have been traced by the auditor through the usual means of examination by him he will not be held responsible. A learned judge (*Lopes, L. J.*), in the case which we shall cite hereafter, aptly puts it that 'the auditor is a watch-dog and not a blood-hound,' by which it is meant that the first care and duty of the auditor is to see that everything is alright, and above par, as far as the accounts and books he is called upon to examine are concerned. He has to approach the work with a state of mind not of a blood-hound or a detective full of suspicions that something wrong has been done, or must have been done. Of course if, on examination of account books he comes across some times which excite his suspicion, he must dive deep into the facts and figures until he is satisfied that there is nothing wrong, otherwise he will be quite justified in believing a tried and old servant of the company to be honest and examine accounts on that supposition. In arriving at this conclusion, he must examine accounts, but how much of the accounts, or how little of the accounts, he should examine in order to be satisfied, is left entirely to his discretion. The auditor should examine the register of members and a proper certificate cannot be given unless this is done (*Wheatcrofts' Case*, (1873) 29 *L. T.* 324). The cash in bank and in hand must also be checked. In the latter case they may obtain a certificate from the bank concerned (*Fox & Son* v. *Morrish, Grant & Co.*, (1918) 35 *T. L. R.* 126). He does not, so to say, guarantee or under-write the strict accuracy of accounts against errors and frauds. He must, however, remember that his duty begins and ends with the examination of accounts and reporting on them to his

patrons the shareholders. He is not there to advise or direct the board of directors as to the method of conducting the business, nor to admonish them on the propriety or impropriety of borrowing or lending money. He is neither a financial expert nor is he there in the capacity of a valuer. In this connection the following passages in the judgment of *Lindley, L. J., in re. London and General Bank No. 2,* (1895) 2 *Ch. D.* 673 are important. According to his Lordship :—

"It is no part of the auditor's duty to give advice, either to directors or shareholders, as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is being conducted prudently or imprudently profitably or unprofitably. It is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that. But then comes the question. How is he to ascertain that position? But he does not discharge his duty by doing this without enquiry and without taking any trouble to see that the books themselves show the company's true position. He must take reasonable care to ascertain that they do so. Unless he does this his audit would be worse than an idle farce. Assuming the books to be so kept as to show the true position of a company, the auditor has to frame a balance-sheet showing that position according to the books and to certify that the balance-sheet presented is correct in that sense. But his first duty is to examine the books, for the purpose of satisfying himself that they show the true financial position of the company. This is quite in accordance with the decision of *Stirling, J.* in *Leeds Estate Building and Investment Co.* v. *Shepherd,* (1887) 36 *Ch. D.* 787. An auditor, however, is not bound to do more than exercise reasonable care and skill in making enquiries and investigations. He is not an insurer; he does not guarantee that the books do correctly show the true position of the company's affairs; he does not ever guarantee that his balance-sheet is accurate according to the books of the company. If he did, he would be responsible for error on his part, even if he were himself deceived without any want of reasonable care on his part, say by the fraudulent concealment of a book from him. His obligation is not so onerous as this. Such I take to be the duty of the auditor; he must be honest—*i.e.,* he must not certify what he does

not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true. What is reasonable care in any particular case must depend upon the circumstances of that case. Where there is nothing to excite suspicion, very little equiry will be reasonably sufficient, and in practice I believe businessmen select a few cases at haphazard, see they are right, and assume, that others like them are correct also. Where suspicion is aroused more care is obviously necessary; but, still an auditor is not bound to exercise more than reasonable care and skill, even in a case of suspicion, and he is perfectly justified in acting on the opinion of an expert where special knowledge is required."

Here it was also held that "an auditor who presented a confidential report to the directors calling their attention to the insufficiency of the securities on which the capital of the company was invested, and the difficulty of realising them, but in his report to the shareholders merely stated that the value of the assets was dependent on realisation, and in the result the shareholders were deceived as to the condition of the company, and a dividend was declared" was guilty of misfeasance and was bound to make good the amount of dividend paid.

Also *Lopes, J.*, has exhaustively defined the duties of an auditor which may also be noted. (*In re. Kingston Cotton Mill Co., No.* 2, (1896) 2 *Ch. D.* **279**). Here after referring to the judgment in *re. London and General Bank Ltd.*, cited above, to which judgment his Lordship was a party, the duties of the auditor are dealt with by the learned judge in the following terms :—

"It is the duty of an auditor to bring to bear on the work he has to perform that skill, care and caution which a reasonably competent, careful and cautious auditor would use. What is reasonable skill, care and caution must depend on the particular circumstances of each case. An auditor is not bound to be a detective, or as was said, to approach his work with suspicion, or with a foregone conclusion that there is something wrong. He is a watch-dog but not a blood-hound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest, and to rely upon their representations, provided he takes reasonable care. If there is anything calculated to excite suspicion

he should probe it to the bottom; but in the absence of anything of that kind he is only bound to be reasonably cautious and careful."

It is of course necessary that the auditors should make themselves quite familiar with the contents of the articles and the memorandum of the company whose accounts they are examining. Failure to observe this precaution may make the auditor liable to damages in case the company suffered loss in the balance-sheet failing to show the true position of the company's affairs. (*Republic of Bolivia Exploration Syndicate*, (1914) 1 *Ch. D.* 139. In the above case it was held also that in case the balance-sheet did not show the true financial position of the company and damage was caused, the onus of proving that the damage is not the result of a breach of duty on their part is thrown on the auditors, otherwise they are *prima facie* responsible for *ultra vires* payments made on the face of the balance-sheet. With regard to the figure of sundry debtors of the company, the auditor no doubt has to take guidance as to its accuracy from the books of accounts. If, from the books he finds that certain debts which are time barred according to the accounts are allowed to stand, and are accounted for in the balance-sheet, it would be no doubt his duty to object, if they are not written of, and report the fact to the shareholders. But in case there is nothing to show that the said debts are bad or doubtful, he may, on a certificate from the responsible manager pass the item. With regard to the value of assets, particularly fixed assets shown on the balance-sheet, we have seen that the mode of valuation ought to be clearly stated on the balance-sheet. In case, the auditor finds that the valuation is not accurate, all he needed is to get a certificate from an expert before passing these figures. He should particularly take this precaution when he finds that the value of assets has been enhanced since the last balance-sheet instead of being depreciated. Of course it has been held (*Lee* v. *Neuchatel Asphalte Co. Ltd.*, (1889) 41 *Ch. D.* 1) that in case the company's articles of association provided for a distribu-

tion of profits without depreciation on fixed assets, the directors can do so, and the Court will not interfere to prevent such a payment of dividend without deduction of depreciation. Again while reporting on accounts it is not sufficient to state that the balance-sheet does not exhibit a true state of accounts, because the auditors are bound to call attention to what is wrong (*Newton* v. *Birmingham Small Arms Co. Ltd.*, (1906) 2 *Ch. D.* 378 *per Bucklay, J.*, *p.* 387).

For breach of duty the auditor may be sued by the company in an action (*Leeds Estate Building and Investment Co.* v. *Shepherd,* (1887) 36 *Ch. D.* 787); or the liquidator in a liquidation may proceed against him for misfeasance (*In re. London and General Bank,* (1895) 2 *Ch. D.* 673 *C. A.*). If the dividend has been paid out of capital through the default of auditors they may be liable jointly and severally with the directors (*London & General Bank No.* 2, (1895) 2 *Ch.* 673). We have noticed the proposition that auditors are expected to display reasonable care and skill and in case they act honestly they will only be liable for gross negligence or gross incompetence, if therefore but for such negligence or incompetence they would have sent in a different report or would have at least cautioned the shareholders they would be liable (*Henry Squire Cash Chemist* v. *Ball Baker & Co.*, (1911) 106 *L. T.* 107). In this case it was also held that in case of accountants engaged by an individual to investigate a business though it was not the duty of the auditors to take stock they had the right to call for explanations on any particular item or items of the stock-sheet.

It is further laid down by our Indian Companies Act that in case of a banking company, if the company has branches beyond the limits of India, it shall be sufficient if the auditor is allowed access to such copies of extracts from the books of accounts of any such branch as have been transmitted to the head office of the company in British India. [Sec. 145 (3)]. The sub-section here allows access, as it will be noticed, to the statements above

mentioned only in case of banks, and there is no reason why in case of other large companies the same privilege should not be extended if the auditor is excepted to make his audit as complete as possible.

We have already seen that the auditors have to make a report to the members of the company on the accounts examined by them. These reports are to be sent to the secretary or the directors of the company and the letter may be left to deal with same as required by the Act (*Allen Craig & Co.*, (1934) *Ch.* 483). This report is required to be attached to the balance-sheet and it is further required that a reference to the report should be made at the foot of such a balance-sheet and that such a report shall be read before the company in general meeting and shall be open for inspection by any member. Any member of the company is entitled to be furnished with a copy of the auditor's report as well as the balance-sheet *and a profit and loss account or income and expenditure account* at a charge not exceeding six annas for every one hundred words or fractional part thereof (Sec. 135). This right is given in case of public companies to members including the preference shareholders, debenture-holders *and in case of public company on the trustees on behalf of debenture-holder* on the same footing as the holders of ordinary shares of the company (Sec. 146). The report of the directors submitted to the statutory meeting as to cash received and cash payments has also to be certified by the auditors of the company [Sec. 77 (4)]. With regard to the report of the auditors on the balance-sheet and accounts the council of the Institute of Chartered Accountants in England and Wales obtained a joint opinion of eminent counsel on the provisions of the English Companies Act of 1907, which provisions were ultimately incorporated in the last English Companies (Consolidation) Act of 1908 and the present Act of 1929. This opinion may be quoted here for the guidance of those interested in this branch of work :—

(1) In our opinion the auditors' report to be made

pursuant to paragraph (2) of Sec. 19 of the Companies Act, 1907, should, in cases where the auditors have no special comments to make, run as follows :—

Report of the auditors to the shareholders of...... ....Limited.

We have audited the balance-sheet of the.......... Limited dated the............day of..............(here identify it as "above set forth" or "within contained" or a copy of which is annexed hereto and initialled by us, or "a copy of which has been initialled by us.").

We have obtained all the information and explanations we have required.

In our opinion such balance-sheet is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of our information and the explanation given us, and as shown by the books of the company.

We consider that the report should identify very clearly the particular balance-sheet to which it refers, so that there may be no room for after-dispute or confusion, and no danger that by mistake or otherwise the balance-sheet submitted to the shareholders, though bearing the proper date, should not be the one actually referred to in the report.

Perhaps the surest mode of identification is to write the report at the foot, or endorse it on the balance-sheet to be submitted, for by these means the two documents are made inseparable; or in other words, the report runs with the balance-sheet. But, as it appears above, there are alternatives open. In any case the auditors should keep a copy of the balance-sheet, they audit, and place a memorandum of identity thereon, so that if the question arises they may be able to testify certainly as to the matter.

(2) Under the section, the auditors' report is to be attached to the balance-sheet, or referred to at the foot thereof. In the former case we consider that the attachment should be effected either by printing the two documents continuously on the same sheet of paper, or by

fastening the report to the balance-sheet. We consider that the best mode of attachment is that the report should be written or printed at the foot of the balance-sheet, or endorsed thereon.

(3) If the report is not attached to the balance-sheet, there should at the foot of the balance-sheet be words referring to the report, *e.g.*, "The report to the shareholders of Messrs........................the Company's Auditors, on the above balance-sheet is dated the........ day of.............., and is open to inspection."

In our opinion it is for the directors to make the reference and settle the form thereof, and not for the auditors.

(4) In our opinion the Act does not impose on the auditors the duty of seeing that the report is attached to the balance-sheet, or referred to at the foot thereof. This duty, we consider, is imposed on the Company and its directors.

(5) It appears to us that it is not the duty of the auditors to see that the balance-sheet is signed by the required number of directors. Sub-sec. (3) of Sec. 10 clearly contemplates that the balance-sheet is to be issued after the report has been made, for a copy is to be attached or referred to. As to cases in which there are no officer called directors, the balance-sheet should be signed by the manager or other person occupying the position of director, for Sec. 30 of the Act of 1900, with which the Act of 1907 is to be read (see Sec. 52) provides that the term "directors" includes any person occupying the position of director, by whatever name called.

(6) In our opinion it is not the duty of the auditors to supply to shareholders, when requested, copies of the balance-sheet and their report, or to furnish information to individual shareholders.

(7) In our opinion the statement in the form of a balance-sheet referred to in Sec. 21 of the Act of 1907 is a document to be submitted by the directors to the auditors for audit. The document must contain, as the

section requires, a summary of the company's capital liabilities, and assets, giving such particulars as would disclose the general nature of such liabilities and assets, and how the value of the fixed assets has been arrived at, but it is not necessary to include in it a statement of profit or loss. We consider that in many cases the last audited balance-sheet will be a sufficient statement in the form of a balance-sheet; but where the balance-sheet does not state how the value of fixed assets has been arrived at, it would, in order to comply with the section, have to be supplemented by a note or memorandum stating how the value of such assets was arrived at.

Where the balance-sheet, whether supplement as aforesaid or otherwise, is adopted for the purposes of the section as a statement in the form of a balance-sheet, it should in our opinion, be accompanied by a copy of the report of the auditors on such balance-sheet; and if it is so supplemented, the auditors should certify that according to the best of their information the method specified in the supplementary note or memorandum has been adopted.

We consider, however, that it is open to the directors to frame the statement "in the form of a balance-sheet" referred to in Sec. 21 in more general terms than the balance-sheet, provided that it complies with the requirements of the section; but in such case the statement must be audited by the company's auditors, and the result of the audit should be certified at the foot of the statement.

(8) As to the general duties of the auditors, under Sec. 19 of the Act of 1907, we consider that they should perform these duties with due regard to the provisions of the company's articles of association, in so far as those articles are consistent with the Acts, and they should call for all such information and explanations as they consider requisite to enable them to make report to the shareholders contemplated by the section. They should not have the least hesitation in reporting fully as to any unsatisfactory features in the position.

Lastly, we do not consider that the auditor's duties are limited to a comparison of the figures in the balance-sheet and those in the books. No doubt, he has to examine the books, but, as *Lord Justice Lindley* said *In re. The London & General Bank*, (1895) 2 *Ch. D.* 673, "he does not discharge his duty by doing this without inquiry and without taking any trouble to see that the books themselves show the company's true position. He must take reasonable care to ascertain that they do so."

Temple,
13th March, 1908.

Felix Cassel,
R. B. Finlay,
A. R. Kirby,
Francis B. Palmer.

Usually when the report is made in a short paragraph it is printed at the foot of the balance-sheet as suggested in the opinion cited above and in case where a lengthy report is to be made out a separate document is used with a due reference at the foot of the balance-sheet. Late Sir Francis Gore-Brown in his book in joint stock companies (Edn. 35 p. 348) recommends that :—

> "If necessary, the auditors should add any special remarks such as 'No depreciation has been written off plant and machinery for the year;' 'the value of the stock-in-trade is certified by the managing director': 'The item securities and investments includes 1,000 ordinary shares of £10 each of the A. B. Company, Limited, which is in liquidation;' or, 'under the heading mortgages and loans is included interest accrued and due some of which is in respect of interest for-years prior to 1921;' or 'at present prices the investments of the company are not of the value shown above; but this. does not affect the profit and loss account, where only the interest actually received is credited.'"

Another recent case in connection with auditor's duties is the famous case of *City Equitable Fire Insurance Co.*, (1925) *Ch.* 407 with which we have already dealt in connection with the liability of directors. In this case a large amount of money was misappropriated by the chairman of

the board of directors who was an eminent person of high reputation. This was done by converting some of the securities and funds belonging to the company and this misappropriation was concealed from the auditors by informing them that the said funds have been given out as loans at call or short notice and as against that a certificate of stock brokers of the company was produced in which firm of stock brokers, the chairman happened to be a partner. The auditors relied upon these certificates and explanations of the management on this footing and did not inspect the securities or upon these securities being put in proper custody and did not report the matter to the shareholders. They were thus charged in a misfeasance summons with negligence and breach of duty in connection with their duties of the balance-sheet and accounts for three years immediately previous to winding up. In course of judgment *Romer, J.*, in the above case referred to passages from *Lindley, L. J's* judgment in the *London and General Bank case* which we have already cited above and stated that :—

"The auditor in that case, amongst other things, 'saw that the bills and securities entered in books were held by the bank.' and this the Lord Justice plainly treated as being part of an auditor's 'legal standard of duty,' though he did not of course mean that in all cases the bills and securities should be lodged with the bank. He meant 'with the bank or in other proper custody.' Nor is it at all clear whether the Lord Justice meant that in all cases the securities should be personally inspected by the auditor. For an auditor may 'see' that the bank holds the securities in the sense that he satisfied himself of the fact. In the case of a responsible and reputable bank like this, according to the evidence of Mr. Van de Linde, would seem to be the custom of auditors. But I think that it is a pity that there should be any such custom. It would be an invidious task for an auditor to decide as to any particular bank whether its certificate should be accepted in lieu of personal inspection. The custom, too, at once raises the question, much debated in the course of the evidence before me, whether the courtesy of accepting a certificate should be extended to an insurance company or a safe deposit company. Indeed, if once it be admitted that, in lieu of inspecting the securities personally, the auditor may rely upon the certificate of the person in whose custody the securities have

properly been placed, the auditor would be justified in accepting the certificate of any official of the company who happened to be in charge of the safe in which the securities are placed, supposing such official to be a reputable and responsible person. At some time or other it will, I think, have to be considered seriously whether it is not the duty of an auditor to make a personal inspection, in all cases where it is practicable for him to do so, whatever may be the standing and character of the person or company in whose possession the securities happen to be. I do not, however, propose to investigate this question further upon the present occasion. For an auditor is not in my judgment ever justified in omitting to make personal inspection of securities that are in the custody of a person or company with whom it is not proper that they should be left. Whenever such personal inspection is practicable, and whenever an auditor discovers that securities of the company are not in proper custody, it is his duty to require that the matter be put right at once, or if his requirement be not complied with, to report the fact to the shareholders, and this whether he can or cannot make a personal inspection. The securities, retained in the hands of Ellis & Co., for periods long beyond the few hours in which securities must necessarily be from time to time in the possession of the company's stock-brokers, were not in proper custody. That Ellis & Co. were at all material times regarded, and reasonably regarded, by Mr. Lepine as a firm of the highest integrity and financial standing is not to the point. A company's brokers are not the proper people to have the custody of its securities, however respectable and responsible those brokers may be. There are of course occasions, when, for short periods, securities must of necessity be left with the brokers, but the moment the necessity ceases the securities should be lodged in the company's strong room or with its bank, or placed in other proper and usual safe-keeping. In my judgment, ont only did Mr. Lepine commit a breach of his duty in accepting, as he did from time to time, the certificate of Ellis & Co., that they held large blocks of the company's securities, but he also committed a breach of his duty in not either insisting upon those securities being put in proper custody or in reporting the matter to the shareholders. This was negligence, and but for Article 150, it would be my duty so to declare and to order Messrs. Langton & Lepine to make compensation for all the damages that such negligence caused to the company, directing an inquiry to ascertain what those damages were. For it is settled by authorities that are binding upon me that an auditor is an officer of the company within the meaning of Sec. 215 of the Companies (Consolidation) Act, 1908, though Mr. Stuart Bevan, while admitting that it was not open to him to argue the contrary in this Court, reserved to his clients the right to contest the point in a superior one. But Article 150 in express

terms includes the auditors of the company in the protection that it gives, and it must be taken to be one of the terms upon which the auditors were employed and gave their services. They are therefore protected, unless the negligence of Mr. Lepine in the matter was wilful. This it certainly was not, unless I am mistaken as to the true meaning of the phrase 'wilful negligence.' I have heard Mr. Lepine's evidence in the witness box, and I have inspected many of the numerous documents prepared by him for the purposes of the audits that he conducted. I am convinced that throughout the audits that he conducted he honestly and carefully discharged what he conceived to be the whole of his duty to the company. If in certain matters he fell short of his real duty. it was because, in all good faith, he held a mistaken belief as to what their duty was. As against him and his partner, the application of the official receiver must accordingly be dismissed."

NOTE :—The Article 150 referred to above was the usual indemnity clause which is now under S. 86C void.

This was improved upon in the Court of Appeal where it was virtually laid down that an auditor should not be content with a certificate that the securities are in possessions of any person or body of persons however trustworthy unless and until he is himself satisfied that the certificate given by a bank or other person is by such institutions or parties who in the ordinary course of business would usually be entrusted with securities. Here of course the auditor is expected to use his own judgment. Here the Master of Rolls in course of his judgment while dealing on this point stated as follows :—

"On the other hand, it may be said that it is the duty of an auditor not to take a certificate as to possession of securities unless from a person who is not only respectable—I should prefer to use the word 'trustworthy'—and also of that class of persons who in the ordinary course of their business do keep securities for their customers, and it may be said that a broker does not in the ordinary course of business keep securities for his customers, and therefore he is ruled out because the auditor ought not to accept from a person of that class, whether he be respectable or not, a certificate that he has got securities in his hands. Now, accepting the rule as stated, that it is right to find the securities in the hands of the bank whose business it is to hold securities, and applying the proviso that that bank must be one that is trustworthy, it seems to me that that rule may be a right rule to follow, and I

think it is *prima facie*, but it is going too far to say that under no circumstances may you be satisfied with securities in the hands of a stock-broker, because it seems to me in the ordinary course of business you must from time to time, and you legitimately may, place in the hands of stock-brokers securities for the purpose of their dealing with them in the course of their business. With a large institution like the City Equitable Company, with a very considerable amount of investments to make and investments to sell, it may well be that for the purpose of the convenience of all parties it may have been a useful method of business even if it had been examined with the most exiguous care, for the directors to decide that they would in the interests of their business leave securities of a considerable amount in the hands of their stock-brokers, who, I suppose, at that time held a position not less trustworthy or respected than the *City Equitable* itself. I therefore do not wish in any way by anything that I say to discharge the auditors from their duties as laid down in the *Kingston Cotton Mills case,* far less do I wish to discharge them from their duty of seeing that securities are held and only accept the certificate that they are so held from a respectable, trustworthy and responsible person, be that person the bank or be it somebody else, but in applying my mind to the facts of this case I am not content to say that simply because a certificate was accepted otherwise than from a bank therefore there was necessarily so grave a dereliction of duty as to make Messrs. Langton & Lepine responsible. I think in the light of the evidence which has been given it is for the auditor to use his discretion and his judgment, and his discrimination as to who he shall trust; indeed I think that is the right way to put a greater responsibility on the auditors.

If you merely discharge him by saying he accepted the certificate of a bank because it was a bank you might lighten his responsibility. I think he must take a certificate from a person who is in the habit of dealing with and holding, securities, and who he, on reasonable grounds, rightly believes to be, in the exercise of the best judgment, a trustworthy person to give such a certificate. Therefore I by no means derogate from the responsibility of the auditor, I rather throw a greater burden upon him, but at the same time, I throw a burden upon him in respect of which the test of common sense can be applied and common business habits can be applied, rather than a rigid rule which is not based on any principle either of business or common sense."

It is also held that accountants who do the duties of auditors without being regularly appointed may become *de facto* officers of the company, though the services of an

accountant are not always to be taken as given in the capacity of auditors (*Western Counties Steam Bakeries*, (1897) 1 *Ch.* 617). It was further held in this case that an auditor who was merely called into audit *pro hac vice* was not an officer.

Concession to Banking Companies only

We have seen that in Sec. 145 (3) there is a provision that in case of banking companies if the company has branch banks beyond the limits of India, the auditor is allowed to be satisfied with copies of abstracts from books and accounts of any such branch transmitted to the head office of the company in British India. Here it should be noted that this concession is given only to banking companies and that too in connection with branches beyond the limits of India. Frequently in India it is taken for granted that this rule also applies to branches within India, not only of banking companies but also of non-banking companies. It is very doubtful whether this practice in connection with audit of companies with branch offices would be upheld by the Courts in view of the fact that the statute clearly emphasises its application to banking companies and that too in connection with branches outside the limits of India.

The directors, as in case of other responsible officers of the company, have the right to presume, unless anything wrong is discovered, that the auditors as responsible officers are doing their duty and thus they are not by law required to supervise or test the auditors' work (*Dovey* v. *Cory*, (1901) *A. C.* 477). In case of winding up the auditors can be compelled to give the books and papers to the liquidator, subject of course to their lien for costs, charges and fees, for any work done by them in connection with the company (*Findlay* v. *Waddell*, (1910) *S. C.* 670). It has also been added that though auditors are agents of the shareholders, constructive notice of facts to them is not the notice to the shareholders (*Spackman* v. *Evans*, (1868) *L. R.* 3 *H. L.* 171).

Auditors' Report

We have already seen in the discussion above, the form in which Sec. 145 (2) of the Indian Companies Act, 1913 requires the auditors to present this report. This report may be published on a separate piece of paper, or if it is the usual formal report called in the popular parlance auditor's certificate, the same may be written at the foot of the balance-sheet itself as it is usually the case. In case the auditor is not satisfied on any point in connection with the income or expenditure account or the profit and loss account, the balance-sheet or accounts in general, or is not able to verify it from vouchers and books placed before him; or where he is of opinion that proper depreciation has not been provided for, or that assets are not correctly valued, it is his duty to bring that fact out in his report. The usual practice is to publish a certificate or report at the foot of the balance-sheet and make it clear there that the same is subject to the remarks and qualifications covered by a separate report. Thus it is quite usual to see remarks in the report such as "depreciation on plant and machinery has not been written off" or "stock as certified by the managing agents," "the securities and investments include X, Y, Z which do not carry any market value at present, but have been shown in the balance-sheet at cost without depreciation or provision in reserve fund." Frequently, great pressure is brought on the auditors not to qualify their reports by such remarks on the plea that that would injure the interests of shareholders. This is no doubt a plausible excuse but if they fail to discharge their duties, they would be liable here for neglect. The auditors no doubt may take legal opinion, or opinions of experts, on points on which they have some doubt, but what the law expects them to give is their own opinion (*In Edington* v. *Fitzmaurice*, (1885) 29 *Ch. D.* 459 *at p.* 483). We have already seen that an auditor's report if founded on a wrong principle of law will not be binding (*Johnston* v. *Chestergate Hat Mfg. Co.*, (1915) 2 *Ch.* 338; *Thomas* v. *Hamlyn & Co.*, (1917) 1 *K. B.* 527).

INVESTIGATION OF AFFAIRS BY INSPECTORS

In connection with the investigation and inspection of books of accounts and generally speaking of the affairs of the company, the Indian Companies Act, 1913 has left ample powers under Secs. 138-143. Here the inspection provided for may be divided into two divisions, *viz.*, (1) investigation through the appointment of inspectors by the local government and (2) that by the company itself by appointment of inspectors of its own choice.

Inspection through Government Inspectors

In this connection Sec. 138 provides that the local government may appoint one or more competent inspectors to investigate the affairs of the company and to report thereat in such manner as the local government may direct :—

(1) In the case of a banking company having a share-capital, on the application of members holding not less than one-fifth of the shares issued;

(2) In the case of any other company having a share-capital, on the application of members holding not less than one-tenth of the shares issued;

(3) in the case of a company not having a share-capital, on the application of not less than one-fifth in number of the persons on the company's register of members;

(4) in the case of any company, on a report by the registrar under sec. 137, sub-sec. (5) .

The above application will have to be supported by such evidence as the local government may require for the purpose of showing that the applicants had good reason for such inspection and that they are not actuated by malicious motive in requiring the investigation. The local government may before appointing such inspectors require the applicants to give security for payment of the cost of enquiry (Sec. 139). As soon as the inspection is ordered it is the duty of all persons who are, or have been, officers of the company, to produce to the inspectors all books and documents in their custody or power relating to the company. The inspectors in this case have the right to

examine on oath any such person in relation to the company's business. If any person refuses to produce any book or document which it is his duty to produce under the section or refuse to answer any question relating to the affairs of the company, he is liable to a fine not exceeding Rs. 50 in respect of each offence. The inspectors must report their opinion at the conclusion of investigation to the local government, a copy of which report will be forwarded by the said government to the registered office of the company and a further copy shall at the request of the applicants for the investigation be delivered to them. The report must be written or printed as the local government directs. The expenses of and incidental to the said investigation are to be defrayed by the applicants unless the local government directs same to be paid by the company under the authority given to it by the section (Secs. 140-141). *In case where investigation is held under S. 138 (iv) on the report of the registrar under S. 137 (5) the expenses of and incidental to the investigation must be paid out of the assets of the company and shall be recoverable as an arrear of land revenue [S. 141 (3)]. The registrar must keep the copy of the report sent to him with the records of the company in his custody [S. 141 (4)].* The power of inspection is one against which the High Court will not grant a prohibition with a view to prevent the holding of such an examination on oath of an officer (*Grosvenor Hotel Co.,* (1897) 76 *L. T.* 337).

Investigation by the company itself

The company itself is also given the power to order such an investigation by Sec. 142 which it can do by passing a special resolution. Frequently articles of association contain special clauses providing for such inspection through an ordinary resolution of the company. In the examples given of such articles in this book in connection with this chapter it will be noticed that Indian companies generally do insert an article giving such power of investigation to the company by an ordinary resolution. In absence of

such an article the company can exercise this power given to it by the Statute by a special resolution only. The power of inspection being given by the Act or Statute cannot of course be taken away, though it can be simplified by an Article such as the one we have indicated above. The inspectors appointed by the company under this section shall have the same powers and duties as inspectors appointed by the local government, except that, instead of reporting to the local government they shall report in such manner and to such persons as the company in general meeting may direct. The officers concerned will incur the same penalty for refusal to produce the books or documents as in case of inspectors appointed by the Government as well as for not answering any questions which they are bound to answer to the inspectors appointed by the Government.

It may be added that the copy of the report of any of these inspectors appointed either under the first or the second heading authenticated by the seal of the company whose affairs were investigated, shall be admissible in any legal proceedings as evidence of the opinions of the inspectors in relation to any matters contained in the report (Sec. 143).

Articles dealing on Audit and Auditor's duties as given in Table A, as distinguished with the forms in use in India by Indian companies.

Table A—Clause 111 :—Auditors shall be appointed and their duties regulated in accordance with Secs. 144 & 145 of the Indian Companies Act, 1913, or any statutory modification thereof for the time being in force.

NOTE :—In case of Indian companies, articles on this point are more detailed in connection with audit. The first clause is as follows :—

"Once at least in every year except the year 1932 the accounts of the company shall be examined and the correctness of the profit and loss account and balance-sheet ascertained by one or more auditor or auditors."

The subsequent clause is more or less all embracing dealing with the appointing of auditors which is as under :—

"The company shall once during each year at an ordinary general meeting appoint an auditor or auditors to hold office until the next ordinary general meeting and the following provisions shall have effect that is to say :—

(1) A director or officer of the company shall not be capable of being appointed auditor of the company.

(2) A person other than a retiring auditor shall not be capable of being appointed auditor at an ordinary general meeting unless notice of an intention to nominate that person to the office of auditor has been given by a shareholder to the company not less than fourteen days before the meeting and the company shall send a copy of any such notice to the retiring auditor and shall give notice thereof to the shareholders either by advertisement or in any other mode allowed by the articles not less than seven days before the meeting. Provided that if after notice of the intention to nominate an auditor has been so given an ordinary general meeting is called for a date fourteen days or less after the notice has been given, the notice though not given within the time required by this provision shall be deemed to have been properly given for the purposes thereof and the notice to be sent or given by the company may instead of being sent or given within the time required by this provision be sent or given at the same time as the notice of the ordinary general meeting.

(3) The first auditors of the company may be appointed by the directors before the statutory meeting and if so appointed shall hold office until the first ordinary general meeting unless previously removed by a resolution of the shareholders in general meeting in which case the shareholders at the meeting may appoint auditors.

(4) The directors may fill any casual vacancy in the office of auditors but while any such vacancy continues the surviving or continuing auditor or auditors (if any) may act.

Sometimes a clause with reference to the qualification of directors runs as follows :—

"No person shall be eligible as an auditor who is interested, otherwise than as a member in any transaction of the company; but it shall not be a necessary qualification for an auditor that he be a member of the company; and no director or officer shall, during his continuance in office, be eligible as an auditor."

With reference to remuneration the clause runs as follows :—

"The remuneration of the auditors shall be fixed by the company in general meeting except that the remuneration of any auditors appointed before the statutory meeting or to fill any casual vacancy may be fixed by the directors."

The clause dealing with the right of auditors of excess to books and their report is more or less on the following term :—

"Every auditor of the company shall have a right of access at all times to the books and accounts and vouchers of the company and shall be entitled to enquire from the directors and managing agents and officers of the company such information and explanations as may be necessary for the performance of the duties of the auditors.

The auditors shall make a report to the shareholders on the accounts examined by them and on every balance-sheet *and profit and loss account* laid before the company in general meetings during their tenure of office and the report shall state :—

(*a*) whether or not they have obtained all the information and explanations they have required.

(*b*) *whether or not in their opinion the balance-sheet and the profit and loss account referred to in the report are drawn up in conformity with the law;*

(*c*) whether or not such balance-sheet exhibits a true and correct view of the state of the company's affairs according to the best of their information and the explanations given to them and as shown by the books of the company.

(*d*) *whether in their opinion books of account have been kept by the company as required by S. 130.*

Sometimes a brief clause in connection with sub-clause (*c*) above is stated as follows :—

"The auditors shall be supplied with copies of the statement intended to be laid before the next ordinary general meeting and it shall be their duty to examine the same with the accounts and vouchers relating thereto, and to report thereon to the members, or to the meeting generally or specially as they may think fit."

A clause under S. 145 (4) of the Indian Companies (Amendment) Act, 1936, may now be conveniently added as follows :—

The auditors of the company for the time being shall be entitled to receive notice of and to attend any general meeting

of the company at which any accounts which have been examined or reported on by them are to be laid before the company and they may make any statement or give explanation they desire with respect to the accounts.

Clauses are also to be found emphasising the conclusiveness of accounts after their audit and after a certain period such as three months has expired. The following is an example :—

"Every account of the directors when audited and approved by a general meeting shall be conclusive except as regards any error discovered therein within three months next after the approval thereof. Whenever any such error is discovered within that period the account shall forthwith be corrected and thenceforth shall be conclusive."

CHAPTER XVIII

Stock Exchange Regulations Applying to Companies

Stock exchanges all over the world have formulated their special rules and regulations applying to shares and stock of joint stock companies in connection with dealings on their exchanges or markets. These regulations have very largely influenced the improvement in the articles of association, thereby tending to safeguard the interest of the investors or holders of shares and stock. This is due to the fact that members of the exchange are naturally anxious to protect the interest of their customers as well as their own, many of them being holders and operators in a large way of shares and stock of joint stock companies. Frequently, most undesirable articles, attempting to put forth most pernicious principles detrimental to the interest of investors in general, have been attempted to be engrafted in the articles of association of some of our joint stock companies, as well as of those in England, which tendency has been most effectively prevented through a timely warning from the Stock Exchange Committee to the effect that such an article would result in a refusal to permit dealings in shares and stock of these companies on the exchange. The stock exchange authorities both in India and England have very successfully in the past used this influence and power for preventing that which legislation alone could otherwise have done. The greatest influence which these exchanges now exercise is in connection with the formation of companies, where, unless the said formation has been carried out in accordance with their rules, a quotation for dealing on the exchange is invariably refused. Thus the promoters of new companies have perforce to obey the regulations of the stock exchange.

Dealings in new and other issues on the Bombay Stock Exchange

Before shares and stock of any company are dealt with on the exchange, permission for such dealings has to be obtained from the board of directors. These applications for dealing have to be made to the secretary of the association in writing by the secretary of the company, or by a member of the association who desires permission for dealing in shares or securities of such companies. The secretary thereupon places this application before the board of the association for information of members for one week prior to the consideration of the board of directors (R. 249). Complete information has to be furnished in connection with those securities as may be required by the board of directors of the exchange and the board of directors may according to their discretion grant or reject any application for admission of the said securities for dealings on the market. Of course permission would not be granted unless the requirements and conditions as laid down in the stock exchange rules have been carried out. In some rare cases the board may, by a resolution of two-thirds of those present, dispense with the strict enforcement of these rules, but that too in cash of transactions only (R. 248). These rules and regulations are very interesting to all company secretaries, promoters, directors, as well as shareholders and thus they may be quoted verbatim as follows :—

Permission Necessary

Sec. 247 (*a*).—No dealings whether for cash or for the account in the shares or securities of any company will be allowed unless permission for such dealings shall have been given by the board of directors;

Amalgamation or Reorganisation

(*b*) Permission is not necessary for dealings in new issues arising from the reorganisation or amalgamation of companies in the shares or securities of which dealings have already been allowed.

Grant or Rejection of Application

Sec. 248.—The board of directors shall consider and may in their discretion grant or reject any application for the admission of the shares or securities of a company to dealings on the market, provided that no application for such admission shall be granted unless the requirements and conditions hereinafter set out shall be complied with, provided however that the board of directors may, by a resolution passed by a majority of two-thirds of the members present at a meeting dispense with the strict enforcement of this rule for the purpose of cash transactions only.

Application how to be made

Sec. 249 (*a*).—Application for admission to dealings must be made to the secretary of the association in writing by the secretary of the company or by a member of the association who desires permission for dealings in the shares or securities of such company;

Notice of Application

(*b*) The said secretary shall place any such application on the notice board of the association for the information of members for one week previous to its consideration by the board of directors.

Information to be Furnished

Sec. 250.—A member who applies for permission for dealings in the shares or securities of any company must furnish the board of directors with all such full and authentic information and all such particulars as the said board may require.

Vendor's Securities

Sec. 251.—No dealings shall be allowed in the shares or securities issued by a company to vendors and credited as fully or partly paid until six months after the date on which permission has been granted for dealings in shares or securities of a like class or description issued to the general public. For the purpose of this rule, shares or securities issued as fully or partly paid to a person or persons or firm or corporation in consideration of the sale or transfer of property or in consideration of services rendered in the formation or promotion of the company shall be deemed vendor's shares or securities.

Conditions of Admitting Shares and Securities of Companies to Dealings

Sec. 252.—The board of directors shall not allow dealings in shares or securities of a company unless :—

Transfer Books open for Registration

(*a*) The company notifies the association that its transfer books have been opened for registration;

Notice to Company of Settlement Days

(*b*) The company agrees not to close its transfer books during days fixed by the association for settlement and of which three months' notice shall have been given by the association to the company;

Articles of Association

(*c*) The articles of association contain the following provisions :—

(*i*) that none of the funds of the company shall be employed in the purchase of or in loan upon the security of its own shares;

(*ii*) that the borrowing powers of the board of the company's directors are limited *to a reasonable amount not exceeding the issued capital.*

(*iii*) that the non-forfeiture of dividends is secured;

(*iv*) that a common form of transfer shall be used *and there shall not be any restriction on the transfer of fully paid shares.*

(*v*) that fully paid shares shall be free from all lien *and in the case of contributory shares the company may have a lien only for all moneys called or payable at a fixed time in respect of such shares.*

Fair allotment

(*d*) (*i*) A new company desirous of issuing the full number of authorised shares or securities or part thereof shall have invited application from the public and shall have allotted to the public fairly and unconditionally at least 33 per cent. of the number of shares or securities issued in equal proportion as to class or kind. For the purpose of this Rule, vendor's shares or securities shall not be considered to form part of such public allotment;

Compliance with conditions of fair allotment

(*ii*) If the company satisfies the board of directors that the company invited applications for at least 33 per cent. of the shares or securities issued, for a period of not less than eight days and that the public did not apply for 33 per cent. of the number of shares or securities issued and that in consequence less than 33 per cent. of such shares of or securities have been allotted to the

public, the company shall be deemed to have complied with the provisions of this Rule;

Different classes

(*iii*) In the case of a proposed issue consisting of two or more classes, the failure to allot the shares or securities of any class or classes in the proportion herein prescribed shall disqualify such class or classes for admission to dealing;

Dealings in bonus shares

(*iv*) Dealings shall be allowed in the shares or securities of a new company which have been issued by an existing company already admitted to dealings and which has given such shares or securities as bonus to its own shareholders; and the provisions of this Rule prescribing the allotment of a proportion of shares or securities to the public shall not apply to such shares or securities;

Registration

(*e*) The company shall have been registered under the Indian Companies Act and its prospectus shall have been filed with the registrar of joint stock companies in India and a copy of the prospectus thus filed shall have been advertised in newspapers published in Bombay;

Prospectus

(*f*) The prospectus shall have been advertised in the public press and the public subscription list shall have been kept open for at least four days;

Information

(*g*) The following *documents and* particulars shall *be sent to the association* by the Secretary of a new company under his signature, namely, articles of association and in the case of a debenture issue a copy of the Trust Deed, the number of shares allotted to vendors and their distinctive numbers, the number of shares offered to the public, the number of shares applied for by the public and the number of shares allotted to the public unconditionally pursuant to such applications and the proportion of the allotment, the total number of allotees and the largest number of shares applied for by and allotted to any one applicant. Where the whole of the capital has not been issued at the time when shares are offered for subscription, the company shall state whether the unissued shares are vendor's shares or are held in reserve for future issue;

Splitting of share certificates

(*h*) The company shall have undertaken to split up the share certificates in lots as required by a shareholder who holds a certificate for a larger number of shares.

Reports and changes in Directorate Sec. 252 (*i*). *The company shall have undertaken*

(1) *To forward to the association copies of statutory and Annual Report and Accounts as soon as issued; as well as*

(2) *To notify the Association of any changes in the directorate by death, resignation, or removal.*

Increase of Capital

Sec. 253.—Where a company intends to increase its capital by an issue of new shares or securities, fifteen days' notice of such proposed increase must be given to the Association by writing under the signature of the secretary of the company before such new shares or securities may be admitted to dealings on the market. The tender for delivery of such new shares or securities shall not be valid on the contract for the shares or securities of such company unless such new shares or securities shall have been admitted to dealings.

FORWARD LIST

Conditions of admission to Forward dealings

Sec. 254 (*a*).—The board of directors in their discretion, have power to admit the shares of any particular company (except the shares of a Bank) to dealings for the Account and Settlement *subject to* the following conditions :—

(1) The company undertakes to maintain an office in Bombay for registering the shares in the name of the transferee and to use the common form of transfer;

(2) All the shares are fully paid-up;

(3) The company shall have paid to the shareholders dividends for the three years last preceding the application *for admission under this rule;*

(4) The company undertakes to split up its share certificates in the lots required by a shareholder who holds a certificate for a larger number of shares;

(5) The company undertakes to close its transfer books on such days as may be convenient to the Association for

the purpose of Settlement and on the days of which the company shall have had three months' notice.

(6) *The company agrees to pay an annual fee in respect of the clearing charges if required;*

Resolution admitting to Forward dealings

(*b*) A resolution of the board of directors admitting the shares of company to the account and settlement must be passed by a majority of two-thirds of the members present at a meeting of the said board, specially summoned and at which not less than three-fourths of the total number of the members shall have been present.

Provided that the board of directors may by a resolution passed by not less than three-fourths of the total number of director admit to dealings for account and settlement under this rule the shares of a company which has not complied with condition 3 but which shall have been incorporated for not less than three years previous to the date of its application for the admission of its share.

Withdrawal of Permission to deal

Sec. 255.—The board of directors may by a resolution passed by a majority of three-fourths of the members present at a meeting specially summoned at which not less than three-fourths of the total number of the members of the said board shall have been present after one month's notice in writing has been served upon the company, *for breach or non-compliance with and of the conditions of the foregoing clauses* to be recorded in the minutes of the said board, remove such share either from the list of shares admitted to cash or forward dealings or from both as the case may be.

Brokerage and Commission Charge on Shares, Stocks and Debentures of Companies

The rates of brokerage to be charged by members for the purchase or sale of stocks, shares and like securities shall be as follows :—

There shall be a minimum charge of Rupee one on each transaction.

(*a*) On debentures of Railways and debentures of joint stock companies generally ¼ per cent. on stock.

(*b*) On the contract price of shares of joint stock companies when such price does exceed

	Rs.	10	... ...	...	...		Rs.	0-2	per	share
exceeds	„	10	but does not	exceed	Rs.	25	„	0-4	„	„
„	„	25	„ „ „	„	„	50	„	0-8	„	„
„	„	50	„ „ „	„	„	75	„	0-12	„	„
„	„	75	„ „ „	„	„	100	„	1-0	„	„
„	„	100	„ „ „	„	„	250	„	1-4	„	„
„	„	250	„ „ „	„	„	750	„	2-8	„	„
„	„	750	„ „ „	„	„	2,000	„	5-0	„	„
„	„	2,000	„ „ „	„	„	5,000	$\frac{1}{4}$ per cent. on value of such shares.			
„	„	5,000	„ „ „	„	„		$\frac{1}{8}$ per cent on value of such shares.			

This rule shall not apply to the underwriting or the placing of new issues.

Scale of Brokerage for Negotiation of Loans

Subject to a maximum $\frac{3}{4}$% a member may charge as brokerage at rates not exceeding $\frac{1}{16}$ % per month on the amount of the loan against securities of joint stock companies.

CHAPTER XIX

Income Tax as Applicable to Joint Stock Companies

The object of this chapter is to deal with the question of income tax as applied to joint stock companies, with a view to provide easy medium of reference for lawyers, secretaries, directors and managers of joint stock companies.

What is a Company?

A company is defined by the Indian Income Tax Act of 1922, Sec. 2 (6), as follows :—

> "Company" means a company as defined in the Indian Companies Act, 1913, or formed in pursuance of an Act of Parliament or of Royal Charter or Letters Patent, or of an Act of the Legislature of a British possession, and includes any foreign association carrying on business in British India, whether incorporated or not, and whether its principal place of business is situated in British India or not, which the Central Board of Revenue may, by general or special order, declare to be a company for the purposes of this Act.

The above definition thus embraces all companies for the purpose of Income Tax Act, *i.e.*, those which have their capital divided into shares as well as those which have no share, but are limited by guarantee. In case of foreign companies it is laid down that they would fall under the Income Tax Act as companies in case (1) they carry on business in India, whether incorporated or not and whether their principal place of business is situated in India or not and (2) if the central board of revenue has, by a general or special order, declared them to be companies for the purpose of this Act. Thus foreign companies, which are formed under various circumstances and various enactments and may or may not be incorporated bodies, though they

resemble very much our companies under the Indian Companies Act, have been brought in. The central board is given this power of declaration only in case of foreign companies as against British companies, *i.e.*, those formed in British Empire and if they carry on business in British India. In case of companies incorporated in India, they need not carry on business in British India. Of course companies such as those formed under Sec. 26 of the Indian Companies Act, 1913 not for profit but for promoting commerce, science or for charity or any other useful object and to apply or intend to apply their profits and income to promoting such objects prohibiting payment of dividends to members, are not included in the Income Tax Act.

The companies which are formed for the purpose of agricultural business have also to be exempt from the Act, for the simple reason that under Sec. 4 (3) (viii) agricultural income is exempt from taxation. Agricultural income here means rent, or revenue derived from land, which is used for agricultural purposes and is either assessed to land revenue in British India or subject to a local rate assessed and collected by officers of the Government as such, as well as any income derived from such land, by agriculture or by performance by a cultivator or receiver of rent in kind of any process ordinarily employed by a cultivator or receiver of rent in kind to render the produce raised or received by him fit to be taken to the market; also income derived through sale by the cultivator or receiver of rent in kind of the produce raised or received by him in spite of which no process has been performed other than a process of the nature described above and also income derived from any building owned and occupied by the receiver of rent or revenue of any such land or occupied by the cultivator or the receiver of rent in kind or any land in respect to which or produce of which the operations mentioned above are carried on. This is of course subject to the provision that the building is on or in the immediate vicinity of the land and is a

building which the receiver of the rent or revenue or cultivator or the receiver in kind in connection with land requires as a dwelling house or as a store house or for building (Sec. 2 (i), I. T. Act).

Of course in case of companies manufacturing sugarcane or tea, which combine agricultural work with manufacturing business, that much of the income which is derived through the manufacture would be assessable, not the other.

How is a Company Dealt with re. its Income Tax?

The company being an inanimate object created by law naturally deals through its agents as we have already seen and thus the income tax officer communicates with the company in connection with his work with one of its principal officers such as the secretary, the managing agent or the treasurer as the case may be. The principal officer is defined by Sec. 2 (12) of the Income Tax Act, as follows :—

> "Principal officer" used with reference to a local authority or a company or any other public body or any association, means—
>
> (*a*) the secretary, treasurer, manager or agent of the authority, company, body or association, or
>
> (*b*) any person connected with the authority, company, body or association upon whom the Income-tax Officer has served a notice of his intention of treating him as the principal officer thereof.

Generally speaking, the rule followed by the Income Tax Offices is to communicate with the principal officers, but where such persons cannot be found, the powers conferred of treating as the principal officer of the company any other person connected with company, public body or association, are made use of.

MODE OF ASSESSING COMPANIES

A joint stock company pays income tax upon its profit at the maximum rate and has the right to deduct the tax

paid from dividends that may be distributed among its members or shareholders. The shareholder on the other hand can, in his own statement for assessment of income, claim and obtain refund, under Sec. 48 of the I. T. Act, by satisfying the income tax officer that the rate of income tax applicable to the profits or gains of the company, at the time of the declaration of such dividend, was greater than the rate applicable to his total income of the year in which such dividend was declared. For this purpose he has to produce the certificate he receives from the company under Sec. 20 of the I. T. Act. This certificate has to be issued by the principal officer of every company at the time of distribution of dividends to every person receiving a dividend to the effect that the company has paid or will pay income tax on the profits which are being distributed and satisfying such other particulars as may be prescribed. The profits of the company is thus charged with income tax at the maximum rate irrespective of what the amount of profits may be under the Finance Act. The form of certificate will be discussed later.

Formerly it was held that a company paid its income tax on behalf of shareholders among whom its net profits were being divided, and that, the final burden of taxation fell on the shareholder or member (*A. G.* v. *Ashton Gas Co.,* (1904) 2 *Ch.* 623; (1906) *A. C.* 10). This view however is not held in later cases and in this connection the case of *I. R.* v. *Blott,* (1921) 2 *A. C.* 171 is important. In this case it was laid down that the company which pays income tax on its profits is not doing as agent for its shareholders. The tax is paid by itself as a tax-payer and in case the company does not pay any dividend or declare one, the shareholders have no direct concern in the payment. All that the company is entitled to do is that when a dividend is declared it is entitled to deduct from such dividend a proportionate part of the amount of tax previously paid by it, and in that case, the payment by the company operates in relief of the shareholder. There is however no agency involved therein. It was also

laid down that in arriving at the rate of dividend the profits ought to be calculated as inclusive and not exclusive of the amount payable for the year in respect of the income tax (See also *Brooke* v. *Commissioner of Inland Revenue*, (1918) 1 *K. B.* 257 as to this principle applicable also to super-tax). This view has been supported also by a Bombay High Court case, *viz.*, *Parshottam Das Har Kishandas* v. *Central India Spinning, Weaving and Manufacturing Co. Ltd.*, (1918) 42 *Bom.* 579; 1 *I. T. C.* 11, where it was laid down that both in Indian acts as well as in the English, Income Tax is in effect paid on behalf of the shareholder of the company. The other point decided in this case was that in case where preference and ordinary shares are issued by a joint stock company, the preference shareholders are not entitled to have their preference dividend free of income tax where there are no express words to that effect in the contract regulating the rights of parties.

The other important point dealt with by Section 23 (a) (2) is that where the income tax officer is satisfied that the company is under the control of not more than five of its members and that its profits and gains are allowed to accumulate beyond its reasonable needs, existing and contingent, having regard to the maintenance and development of its business without being distributed to the members, or that a reasonable part of its profits and gains, having regard to the said needs, has not been distributed to its members in such manner as to render the amount distributed liable to be included in their total income, and that such accumulation or failure to distribute is for the purpose of preventing the imposition of tax upon any of the members in respect of their shares in the profits and gains so accumulated or not distributed, the income tax officer may, with the previous approval of the assistant commissioner, pass an order that the sum payable as income tax by the company shall not be determined, and thereupon the proportionate share of each member in the profits and gains of the company, whether such profits

and gains have been distributed to the members or not, shall be included in the total income of such member for the purpose of assessment thereon. This sub-section is not to apply to a subsidiary company of another company or to a company in which the public are substantially interested.

This section is meant to meet cases such as that of *Sir Dinshaw Maneckji Petit* v. *Commissioner of Income Tax, Bombay,* (1927) 29 *Bom. L. R.* 447; (1926) 2 *I. T. C.* 255. Here considerable amount of shares and securities belonging to the assessee were purported to be sold to four private limited companies formed by himself in return for shares of such companies, with the result that of the shares of these private companies, all but three shares of the value of Rs. 30 each were not in assessee's name, but those of his employees. The shares and securities were not actually transferred to the company, but by another trust deed executed on the same date it was agreed by the company that they were not to be transferred until the company called upon the vendor assessee to do so that meanwhile the vendor assessee should hold the said securities in his own name as agent and trustee of the company. When the interest and dividends of these shares thus sold were received by the assessee, mere book entries were passed in books of each of the companies crediting each with the amount and on the same day a debit entry was made debiting the assessee with the same amount. Thus the interest and dividend so received were treated as loans given to the assessee by the three companies concerned. These loans carried interest which was credited to the companies in the accounts, but no interest was paid in cash to the companies. The assessee was a governing director of the companies concerned and had entirely the control and management of same. He had power to nominate two other ordinary directors, but no such directors were nominated. Here the Income Tax Commissioner claiming that the companies were not genuine one man companies, but that as the interest and dividend on the securities and

shares were really the Income of the assessee personally he was liable to be assessed in respect thereof. When the case was sent up to the High Court it was held there on a reference that the amounts in dispute represented taxable income of the assessee under the Act; that though the companies were separate entities under the Indian Companies Act, it did not follow therefrom that every alleged transaction between the assessee and the companies was valid or that they represented real transactions. The Crown was entitled to enquire into the genuineness of the transaction between the assessee and the companies and that the evidence had established that the assessee held the securities and shares on his own behalf and for his own benefit, whilst professing to hold them as trustee for a genuine and *bona fide* company, and that the assessee was receiving under the guise of loans or advances, the profits which were made by the companies which he controlled and in which he held almost all the shares. In short, the general trend of decisions has been that although there may be a legal entity as laid down in the case of *Salomon* v. *Salomon*, (1897) *A. C.* 22, this legal entity may be either dealing as agent of another or may be doing business of some other company or body altogether and not that of its own (*M. R. Sterndale in Commissioners of Inland Revenue* v. *Sansom*. (1921) 2 *K. B.* 429; 8 *T. C.* 20; *Gramophone and Typewriter Co. Ltd.* v. *Stanley*, (1908) 2 *K. B.* 89; 5 *T. C.* 358; *Commissioner of Inland Revenue* v. *John Sansom*, (1921) 2 *K. B.* 492; 8 *T. C.* 20).

As it may be added that it has been decided that even though the company happens to be in liquidation or winding up, it is still a company within the meaning of Section 3 of the Income Tax Act, and thus, the Income Tax authorities can call upon the liquidator of such a company to make a return according to Section 22(1) of the Act. This principle was originally laid down in *West Laikdih Coal Co. Ltd.*, (1926) 53, *Cal.* 328 in connection with the cess leviable by the Government, where it was

laid down by *Page, J.*, that the said cess can be recovered from a company in liquidation. This was referred to thereafter in *Commissioner of Income Tax, U. P.* v. *Agra Spinning and Weaving Mills*, (1934) 1 *T. R.* 79.

In other words the tax which is to be paid as dividend by the shareholder is a personal liability of the shareholder who is the real assessee in the case and the deduction by the company at the source is a mere administrative convenience. It is on this ground that Section 16 lays down that in computing the total income of the assessee the amount received by a shareholder in a company by way of dividend shall be included and the amount of his income increased by that amount without deduction of the tax in order to arrive at his total income with a view to fix the rate chargeable to him.

RETURN OF INCOME

With regard to this, the principal officer of every company must prepare, on or before the 15th day of June each year and furnish to the income tax officer, a return, in the prescribed form and verified in prescribed manner, of the total income of the company during the previous year. Of course the income tax officer may, in his discretion, extend the date of delivery of the return in case of any company or class of company (Sec. 22 (1), I. T. Act). In connection with this return it should be remembered that the profits assessed are not profits distributed but actual profits made and computed as laid down by Secs. 8 to 13 of the I. T. Act. We shall deal with the question of what would make up profits for a joint stock company, later under separate heading. In connection with this return it should be noted that the obligation to make this return is a statutory obligation upon the principal officer and it is not necessary that the income tax officer should send any preliminary notice or request to the company or the officer concerned. Failure to furnish this return in time is punishable with fine which may extend to Rs. 10 for every day during which the default continues (Sec. 51

(c), I. T. Act). It should also be noted that the return must be strictly accurate, otherwise a person who furnishes a false return is liable to be punished under the provisions of Sec. 177 or Sec. 182 of the Indian Penal Code. The former section provides a punishment with simple imprisonment for a term, which may extend to six months or with fine, which may extend to Rs. 1,000 or with both, on the footing of furnishing a false information whereas the latter is the offence of furnishing a false information knowing it and believing it to be false and intending it thereby or knowing it to be likely thereby, he will cause the public servant to do or omit to do anything which such public servant ought not to do or omit any true state of facts respecting which such information was given were known to him or to use lawful power of such public servant to the injury or annoyance of any person. The punishment provides for imprisonment of either description for a term which may extend to six months or with fine which may extend to Rs. 1,000 or both. Over and above this, in case of these false returns the assessee is made to pay a penalty by the income tax officer himself not exceeding the amount of tax which would have been avoided if the return had not been accepted as correct. This return of the company is provided for by the Income Tax Act as published in the following form :—

Income, profits or gains from business, trade, commerce.

	Rs.	A.	P.
Income, profits, or gains as per profit and loss account for the year ended........19....			
Add—Any amount debited in the accounts in respect of			
1. Reserve for bad debts...............			
2. Sums carried to reserve for provident or other funds......................			
3. Expenditure of the nature of charity or presents.........................			
4. Expenditure of the nature of capital			
5. Income-tax or Super-tax............			
6. Rental value of property owned and occupied...........................			

	Rs. A. P.
7. Cost of additions to, or alterations, extensions, improvements of, any of the assets of the business...........	
8. Interest on reserve or other funds....	
9. Losses sustained in former years.....	
10. Losses recoverable under an insurance or contract or indemnity............	
11. Depreciation of any of the assets of the business.......................	
12. Expenses not incurred solely for the purpose of earning the profits......	
Total........	
Deduct—Any profits included in the accounts already charged to Indian income-tax and the interest on securities of the Government of India or of Local Governments declared to be income-tax free..........	
Balance........	

If the company owns any property not occupied for the purposes of the business, a statement, in the form prescribed in Schedule A to Rule 19, should be attached with particulars of the credit and debit on account of such property entered in the accounts.

DECLARATION.

I the...*Seccretary,* etc., (see Section 2 (12) of the Act) of the......................(name of company) declare that the information against each head in this return is correctly given as shown in the books of the company as also in the accounts which have been duly audited by the auditors of the company and which have been adopted by the holders of the company.

(Signature)......................

(Designation)......................

Dated............19..

The company shall also attach to the return a statement showing the sums charged in the accounts under the provisions of Section 58K (2).

It may be noted that the company distributes profits from reserve fund whether the past profits have been

accumulated undistributed and has made no profit during the year during which such dividend is paid, the shareholder has still a right to claim a refund of the income tax under Sec. 48 of the I. T. Act. Where however the dividend is paid by the company free of income tax and the company has been already assessed and paid the income tax the shareholder cannot be called upon to pay income tax once again (Sec. 14(2) (a).

It should be here noticed that when a company pays tax by deducting same from the dividends, it does not in any way perform that operation as the agent of the shareholder. It on the contrary pays same as a tax-payer. This is because the tax is not a tax paid on dividends but on company's own profits (*Ashton Gas Co.'s Case*, (1906) *A. C.* 10; *Brooks* v. *Commissioners of Inland Revenue*, (1914) 1 *K. B.* 293; 7 *Tax cases* 236; *in re. Cains Settlement*, (1919) 2 *Ch.* 364).

SUPER-TAX

Super-tax is in fact an additional income tax imposed on the company exceeding the specified amount (*In re. Oldham* v. *Crosse*, (1920) 1 *Ch. D.* 240). The Income Tax Act also in Sec. 55 clearly lays down that in addition to the income tax charged for any year there shall be charged and levied or paid for that year, in respect of the total income of the previous year of any company, an additional duty of income tax, known as super-tax, at the rate or rates laid down for that year by the act of Indian legislature. The companies whose income or profits are in excess of Rs. 50,000 pay a flat rate of super-tax as regulated by the Finance Act. Here also the tax is not paid on behalf of the shareholders but it is paid by the company on its own profit (*Maharaja Dhiraj of Darbhanga* v. *Commissioner of Income Tax, Bihar & Orissa*, (1925) 1. *I. T C.* 303). The total income here means income or profit from all sources. According to Income Tax Manual this super-tax on companies which takes the place of tax formerly levied at a graded scale of rates on the

undistributed profits of the company, is levied on the company as such, on account of special privileges which the companies enjoy by statute in the share of corporate finance and limited liability. Thus no refund on account of super-tax on companies is allowable to shareholders (*See Income Tax Manual*—5th Edition, para 98, page 257). In this connection there is a further provision of the Income Tax Act in Sec. 57 (2), which lays down that :—

> " Where the Income-tax Officer has reason to believe that any person, who is a shareholder in a company, is resident out of British India and that the total income of such person will, in any year, exceed the maximum amount which is not chargeable to Super-tax under the law for the time being in force, he may, by order in writing, require the principal officer of the company to deduct, at the time of payment of any dividend from the company to the shareholder in that year, Super-tax at such rate as the Income-tax Officer may determine as being the rate applicable in respect of the income of the shareholder in that year."

The Income Tax Manual states, in this connection, that this rule has to be employed where special circumstances render it necessary, *e. g.*, where a non-resident has resorted to some device by which proceedings under Sec. 43 have been rendered infructuous. This Sec. 43 provides for recovery of the tax due on behalf of the person residing out of the British India from his agent or employee in British India, having any business connection with such person or through whom such person is in receipt of any income, profits or gains, through a notice served by which the said person is treated as agent of the non-resident person. Before the income tax officer proceeds in the matter, he has to report through the assistant commissioner to the commissioner of income tax and obtain order before proceeding under this Sec. 57 (2). In case of companies this obligation to deduct applies only to dividends and not to other sums which the non-resident may receive from the company by way of interest on debentures or remuneration such as director's fee.

In a winding up, the limited companies' undivided

profits were distributed among the shareholders, and on this, super-tax was not allowed on the ground that on winding up the undivided profits became assets (*Inland Revenue Commissioners* v. *George Burrell,* (1924) 2 *K. B.* 52).

On the question where in case an unregistered firm is converted into a limited company, the profits of the firm for the year previous to that of conversion are to be assessed at the company's rate, it was decided that the assessment was to be at the rate of super-tax prescribed for a company under the Finance Act (*In re. The Western India Turf Club Ltd.,* (1926) 50 *Bom.* 648). In another case where shares were issued as distribution of a part of the reserve fund created out of profits, it was decided that they were subject to the payment of super-tax, but subsequently this decision was reversed in appeal on the ground that this was a distribution of capital, not profits and was not thus assessable (*Commissioner of Inland Revenue* v. *Wright,* (1927) 1 *K. B.* 333; *see also Bouch* v. *William Sproule,* (1887) 12 *A. C.* 385 *at p.* 399 *for Lord Herschell*). Here the House of Lords decided that accumulated profits which had been temporarily capitalised and distributed in the form of bonus dividend in new shares to the shareholders was not tantamount to paying dividend or intending to pay any sum as dividend, but was an appropriation of the undivided profits as an increase of the capital stock. The other important case is where a company (which is virtually speaking a one-man company) is formed with a view to avoid payment of correct super-tax leviable on the profits or income of an individual and formed dominantly with the intention of falling under the flat rate payable by way of super-tax by joint stock companies, the Crown can enquire into the genuineness of the transaction between the assessee and companies formed by him and that they will not in such cases be estopped from claiming that the income previously treated by them to be of the company are incomes of the assessee liable to super-tax. In one Bombay case the

assessee disputed an item of dividend on shares on the ground that they formed income of four private companies formed by him and therefore these companies were liable to super-tax in respect of them. The companies which had the total subscribed capital of thirty to forty lacs, only three shares to the face value of Rs. 30 were not in the assessee's name but in those of his employees. To this company the assessee had purported to sell the bulk of his investments. The income tax commissioner here was of opinion that the companies were not genuine, but were one-man companies and that the interest and dividend on the securities and shares were really the income of the person so as to render him liable in respect of the assessment thereof. The courts on investigation decided that that was the correct position and that the real business was carried on by the assessee himself and not the company, but that the companies were brought in simply for the purpose of avoiding payment of super-tax. Thus the assessee had to pay super-tax personally on the scale of that payable by individuals as against that by the company (*In re. Dinshaw Manekji Petit,* (1927) 29 *Bom. L. R.* 447). The cases followed were *Salomon* v. *Salomon & Co.,* (1897) *A. C.* 22 & *Inland Revenue Commissioners* v. *Sansom,* (1921) 2 *K. B.* 492 *at p.* 514).

It has also been held that when an unregistered firm in India converts itself into a joint stock company, super-tax is to be assessed on the income earned by the unregistered firm prior to its conversion and the tax is to be levied on the flat rate of one anna applicable to the income of a company under Sec. 7 of the Finance Act 1928. (*In re. Western India Turf Club,* (1926) 28 *Bom. L. R.* 1236; *see also* (1928) 30 *Bom. L. R.* 105).

We have seen that under Sec. 28 the income tax officer, in case the return furnished by the assessee turns out to be inaccurate, has the right to impose a penalty. In one Allahabad case the assessee was assessed according to his statement but later on, on reassessment it was found that his income had been much larger than the

figure at which he was originally assessed according to his return. Accordingly he was assessed to income-tax as well as super-tax of a much larger amount and the Commissioner of Income-tax also imposed a penalty upon him with regard to both the enhanced income-tax as well as super-tax. Here it was held that though the income-tax officer had jurisdiction to impose a penalty in the matter of income-tax in the proceedings for an assessment taken under Sec. 34 of the Income Tax Act, the penalty under Sec. 28 can be imposed only in case of excess income tax but not in the matter of super-tax. This was so because the Sec. 28, being a penal section, must be strictly construed and there was not a word in it relating to super-tax (*In the matter of Gurcharan Prasad*, (1931) 53 *All.* 445).

Certificate of Tax Deducted and Refunds

We have seen that in Sec. 20, the principal officer of the company, who distributes the dividend after deducting the income tax at the highest rate, has to give a certificate to every person receiving a dividend to the effect that the company has paid or will pay income tax on the profits which are being distributed and specifying such other particulars as may be prescribed. The shareholder is in his turn entitled to claim a refund of any excess deducted from his dividend under this certificate by production of same to the income-tax officer and proof to the effect that his personal income was much less than the scale at which the deduction was made. The form of certificate under Sec. 20 as prescribed by Rule 14 of the income tax rules is as follows :—

(Name of company)................
(Address of company)..............

Date.....................

Warrant for Rs. (in words and figures or, if the certificate is crossed by an entry in words stating that the amount of dividend is under the next multiple of Rs. 50 above that amount, in........ figures only)......................, being dividend (1) at the rate

of..................Rs. (in words and figures).................per share for the (2)................../the period from............... to..................during the year ending on the............... day of..............19.., (3)..............on (4)................ shares in this company, registered during the said period/on (Date)......................in the name of...................... This dividend was declared at the (5)...................meeting held on the (6)........................19...

I/We hereby certify that income-tax on the entire/such part as is liable to be charged to Indian Income-tax of the profits and gains of the company, of which this dividend forms a part, has been, or will be duly paid by me/us to the Government of India.

Signature.........................

Office............................

(To be signed by the claimant)

I hereby certify that the dividend above mentioned relates to shares which were my own property at the time when the dividend was declared/during the period from................to............ ..../on.............(Date)............and were in the possession of

Signature.........................

Date............................

---

(1) Or dividend and bonus.
(2) Year or half-year, as the case may be.
(3) Here enter whether free of income-tax or not.
(4) Here enter number and description of shares.
(5) Here specify number and nature of meeting.
(6) Here enter date.

The certificate which is furnished by the secretary of the company should supply all the prescribed particulars, even though he may not follow strictly the phraseology or arrangement of the above statutory form. The income tax officer will accept the certificate but will apply the correct percentage of profits. The duplicates of certificates will be accepted if the claimant satisfies the income tax officer who has to sanction the refund that the dividend in respect of the tax on which the refund is claimed had actually been paid to the claimant and if the income tax officer has no reason to believe that a refund has already been granted in respect of same dividend. Of

course the income tax officers will have a right to be convinced as to the reason why the original was not produced. The Income Tax Manual lays down instructions which may with advantage be followed by persons granting certificates described by Sec. 20 of the Act, *i.e.*, Managers or Secretaries of joint stock companies. They are as follows :—

(1) The statutory forms of certificate of deduction of income-tax prescribed by rule 14 of the Indian Income-tax Rules should invariably be used.

(2) Either (*a*) the certificate should be printed on the same sheet of paper as the actual warrant with a line of perforation to permit of its being detached or (*b*) the dividend warrants should be machine-numbered while every certificate relating to a particular dividend should be given the same number as the corresponding warrant. There are cases in which Banks collect dividends on behalf of their constituents and companies send the banks consolidated dividend warrants in payment of all the dividends due in respect of the block of shares for which the bank is acting and at the same time send separate certificates for the shareholders by whom the shares are owned. In such a case if certificates are issued to a bank for say twenty constituents relating to dividend warrant No. 1, the certificates should be numbered by hand 1|1 1|2, 1|3 to 1|20.

(3) The practice adopted by certain companies of either attaching red slips to the certificates drawing the attention of recipients to the need for their careful preservation for a year or two or of printing this caution in red ink on the face of the certificate may be generally followed.

(4) A note should be printed on the certificate to the effect that shareholders may claim refund of tax under Sec. 48 (1) of the act in respect of their dividends if their personal rate of tax is less than the maximum rate.

In case of joint stock companies in connection with refunds on the dividend paid, various points have to be considered by the income tax officer. The dividend may have been paid by the company, a substantial portion of whose income is known to be derived from tax-free securities and thus the company is required to certify, in a statutory form prescribed in Rule 14, as to what percentage of its income in a given year has actually paid tax or is

liable to pay tax. When a shareholder receives a dividend from a company which derives a substantial portion of its income from tax-free securities, the shareholder should only be allowed a refund, under Sec. 48, in respect of a proportion of its dividend corresponding to the proportion of the company's income that is subject to taxes. This means that supposing a company has made a profit of Rs. 5 lacs, which would enable it to pay a dividend of 5%. It however adds to this five lacs other five lacs which it has derived through its investments in securities which are free from income tax. Thus by the combination of these two five lacs from two different sources the company is able to pay a dividend of 10 per cent. When the shareholder claims a refund on account of income tax paid by the company and the company having paid income tax on only half the amount of his dividend, *i.e.*, 50 per cent. of his dividend amount, the refund could only be claimed in connection with this 50 per cent. on which actual income tax was paid by the company.

"When the amount distributed by a company as dividends exceeds the total income, profits or gains, as calculated for income-tax purposes of the company in the year in question, taxed and untaxed, which includes cases where there is no income, profits or gains, or a loss (for example where net receipts from non-tax-free sources are wiped out or exceeded by the depreciation allowance) the refunds to shareholders should be calculated with reference to the proportion borne by the tax-free income to the total amount distributed less the tax-free income.

"Application for refund under the provisions of Rule 39 should, in case where the applicant is resident in British India, be made to the Income-tax Officer of the district in which the applicant is chargeable directly to income-tax or, where he is not chargeable directly to income-tax, to the Income-tax Officer of the district in which he ordinarily resides and such Income-tax Officers are required to give the refunds. In cases where the applicant is resident outside British India, the application should be made to the Income-tax Officer, Non-Residents Refund Circle, Bombay. The Income-tax Officer will, however, allow a claimant who resides in an Indian State, the option of receiving payment of the refund through the Political Officer in that State, that is

to say, the refund voucher that will be issued by the Income-tax Officer will be made payable, if the person applying for the refund so desire, at the Political Treasury of the Government of India in the particular Indian State or if there is no treasury under the control of the Political Officer, at the prescribed British Indian Treasury."

COMPUTATION OF INCOME, PROFITS AND GAINS

The principle on which income-tax is charged on the earnings, of a company, in common with other undertakings, is on the income of a fixed period and if the company exhibits losses for a particular period, the tax on that period is not payable for the loss is not allowed to be carried over to the next period to be deducted from profits, if any, for the next period. The scale of taxation is not laid down by the Income Tax Act itself but is fixed yearly at the beginning of each financial year through the Finance Act in which the details as to the scale are published.

The principle on which taxation is now levied is that the tax is collected in arrear. Thus as soon as the financial year begins the tax is levied at the scale fixed for taxation by the Finance Act of that year on the incomes, profits or gains made on the previous year. The previous year according to the modern position need not necessarily be made up of 12 months. Under Sec. 2 (11) of the Act the previous year may mean 12 months ending on 31st day of March next preceding the year for which the assessment is to be made, or, if the accounts of the assessee have been made up to a date within 12 months in respect of a year ending on any date other than the said 31st day of March, then the option is left to the assessee to make up his accounts up to the date on which he closes his accounts usually. Here of course the condition is that once an option is exercised as to the closing of accounts at the end of a certain period the preparation of the statement should not vary again and the assessee cannot exercise any option for fixing his

accounting period to any other date except with the consent of the income-tax officer and upon such condition as he may think fit. It will be thus seen that the assessee may choose for himself as to whether he will close his accounts every year at the end of the Government year, 31st of March, or at any other date. This regulation now makes it possible for different castes who close their accounts in their year applying to their religion or caste and who do not work according to the ordinary calendar year to prepare accounts on their own calendar. The commercial year thus may consist of more or less than 12 months provided that new commercial year may extend to less than 11 or more than 13 calendar months in any one year. The assessment is of course made in respect of all income, profits and gains. In case of new businesses the profits of the previous year to be assessed need not necessarily be the profits of the whole year, *i.e.*, 12 months, but in case the business starts say on the 1st of June and the accounts are closed on the 31st March in the next year, the assessment would be made on the 9 months ending on 31st March of that year.

In case of Joint Stock Companies the Christian calendar year is usually followed and the company closes its accounts usually on the 31st December every year and thus the tax payable by the company for the Government year 1934-35 will be assessed on the profits of the company for the year ending December 1934. If a company however closes its year of account on 30th June, then it will be assessed for the Government year 1934-35 on the income earned during the year ending 30th June, 1933. This is because this date falls within the Government year 1933-34. The exact language of Sec. 2 (11) and Sec. 3 of the Indian Income Tax Act which governs these rules are as follows :—

Sec. 2(11). "Previous year" means :—

(*a*) the twelve months ending on the 31st day of March next preceding the year for which the assessment is to be made, or, if the accounts of the assessee have been made up to a date within the said twelve months in

respect of a year ending on any date other than the said 31st day of March, then at the option of the assessee the year ending on the day to which his accounts have so been made up :

Provided that, if this option has once been exercised by the assessee, it shall not again be exercised so as to vary the meaning of the expression "previous year" as then applicable to such assessee except with the consent of the Income-tax Officer and upon such conditions as he may think fit : or

(*b*) in the case of any person, business or company, or class of person, business or company, such period as may be determined by the Central Board of Revenue or by such authority as the board may authorise in this behalf.

Sec. 3. Where any Act of the Indian Legislature enacts that income-tax shall be charged for any year at any rate or rates applicable to the total income of an assessee, tax at the rate or those rates shall be charged for that year in accordance with and subject to the provisions of this Act in respect of all income, profits and gains of the previous year of every individual, Hindu undivided family, company, firm and other associations of individuals.

The profits of a company may be made out of its (1) business or out of its (2) property or (3) investments or (4) other sources. We shall now deal with each class separately.

In connection with this Sec. 10 of the I. T. Act is rather important. It runs as follows :—

Sec. 10(1) The tax shall be payable by an assessee, under the head "business," in respect of the profits or gains of any business carried on by him.

(*2*) Such profits or gains shall be computed after making the following allowances, namely :—

(*i*) Any rent paid for the premises in which such business is carried on provided that, when any substantial part of the premises is used as a dwelling-house by the assessee, the allowance under this clause shall be such sum as the Income-tax Officer may determine having regard to the proportional part so used;

(*ii*) in respect of repairs, where the assessee is the

tenant only of the premises, and has undertaken to bear the cost of such repairs, the amount paid on account thereof, provided that, if any substantial part of the premises is used by the assessee as a dwelling-house, a proportional part only of such amount shall be allowed;

(*iii*) in respect of capital borrowed for the purposes of the business, where the payment of interest thereon is not in any way dependent on the earning of profits, the amount of the interest paid;

Explanation :—Recurring subscriptions paid periodically by shareholders or subscribers in such mutual benefit societies as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause;

(*iv*) in respect of insurance against risk of damage or destruction of buildings, machinery, plant, furniture, stocks or stores used for the purposes of the business, the amount of any premium paid;

(*v*) in respect of current repairs to such buildings, machinery, plant, or furniture, the amount paid on account thereof;

(*vi*) in respect of depreciation of such buildings, machinery, plant, or furniture being the property of the assessee, a sum equivalent to such percentage on the original cost thereof to the assessee as may in any case or class of cases be prescribed;

Provided that

(*a*) the prescribed particulars have been duly furnished :

(*b*) where full effect cannot be given to any such allowance in any year, owing to there being no profits or gains chargeable for that year, or owing to the profits or gains chargeable being less than the allowance, the allowance or part of the allowance to which effect has not been given, as the case may be added to the amount of the allowance for depreciation for the following year and deemed to be part of that allowance, or, if there is no such allowance for that year, be deemed to be the allowance for that year, and so on for succeeding years :

and

(*c*) the aggregate of all such allowances made under this Act or any Act repealed hereby, or under the Indian Income-tax Act, 1886, shall, in no case, exceed the original cost to the assessee of the buildings, machinery, plant, or furniture, as the case may be;

(*vii*) in respect of any machinery or plant which, in consequence of its having become obsolete, has been sold or discarded the difference between the original cost to the assessee of the machinery or plant as reduced by the aggregate of the allowances made in respect of depreciation under clause (*vi*), or any Act repealed hereby, or the Indian Income-tax Act, 1886 and the amount for which the machinery or plant is actually sold, or its scrap value;

(*viia*) in respect of animals which have been used for purposes of the business otherwise than as stock-in-trade and have died or become permanently useless for such purposes, the difference between the original cost to the assessee of the animals and the amount, if any, realised in respect of the carcases of animals;

(*viii*) any sums paid on account of land-revenue, local rates or municipal taxes in respect of such part of the premises as is used for the purposes of the business;

(*viiia*) any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission;

Provided that the amount of the bonus of commission is of a reasonable amount with reference to—

(*a*) the pay of the employee and the conditions of his service;

(*b*) the profits of the business for the year in question; and

(*c*) the general practice in similar businesses;

(*ix*) any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains;

Provided that nothing in clause (*viii*) or clause (*ix*) shall

be deemed to authorise the allowance of any sum paid on account of any cess, rate or tax levied on the profits or gains of any business or assessed at a proportion of or otherwise on the basis of any such profits or gains.

(3) In sub-section (2) the word "paid" means actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under this section.

BUSINESS PROFITS

From the above Sec. 10 it will be noticed that the tax is payable under the head of business in respect of profits or gains on any business carried on by the assessee. Business is defined by the Income Tax Act as :—

"Business includes any trade, commerce, or manufacture or any adventure or concern in the nature of trade, commerce or manufacture."

The word business is here used in a very extended sense, than the word trade, though both of these words, in ordinary parlance happen to be synonymous (*Harris* v. *Amery,* (1866) 35 *L. J. C. P.* 89; *Delany* v. *Delany*, (1885) 15 *L. R. Ir.* 67).

M. R. Jessell on page 258 in *Smith* v. *Anderson,* (1880) 15 *Ch. D.* defines business as used in a general sense and sums up to the effect that these are particular occupations such as agriculture, trade, mechanic, art or profession when used in connection with particular employments. Of course in income-tax according to the Act, business is distinguished from profession for the purposes of income-tax. In connection with trade, selling is the most important element and buying alone would not constitute trade, unaccompanied by selling. When a person or firm or a company is said to trade, it must trade with a third party and not with itself in order to make profits and thus in case of a club made up of members to whom the club belongs there cannot be profits in the form of surplus of revenue over expenditure arising from trade unless the club trades with outsiders, *i.e.*, non-members (*United Service Club, Simla* v. *R.*, (1921) 2 *Lah.* 109; 1 *I. T. C.* 113). The club which trades with outsiders like the Turf

Club is carrying on business and making profits through its dealings with non-members and thus falls under the Income Tax Act (*Royal Calcutta Turf Club* v. *Secretary of State*, (1921) 48 *Cal.* 844). In case of mutual societies, generally speaking, where there are no outsiders but shareholders or members, who deal among themselves and not with outsiders, they would not be assessable for their gains or profits, but their investment in banks and securities would be assessable. The same rule would apply to all co-operative societies or concerns similar to them who confine their dealings to members only and who divide their surplus among members and not outsiders. This Rule would apply irrespective of the fact whether the mutual society was incorporated under the Companies Act or any other Act (*New York Life Insurance Co.* v. *Styles*, (1889) 14 *A. C.* 381). In this case the majority of the Court of Appeal decided that in case of a life insurance company which had no shares or shareholders and where the only members were the holders of participating policies, each of whom was entitled to a share of the assets and liable to all losses, that the surplus arrived at from premiums paid by these members after making all reserves for probable death-rate among members and the probable expenses and the other liabilities was not assessable to income-tax whereas that derived from investments and all other transactions with persons not members was assessable under the Income Tax Act. The principle here enunciated would naturally be the basic principle applicable to all co-operative societies and mutual trading or insurance associations.

In connection with this it should be remembered that the old Income Tax Act only used the word "income" and that word was construed by the Courts to carry a very limited meaning with the result that the present wording has been introduced in the later acts with a view to bring in all incomes or gains from business, professional earnings or other sources. Of course in trying to arrive at the profits or gains of a business, the usual mercantile

accountancy system is universally followed by joint stock companies in common with business firms and partnerships in the mercantile world, the actual receipts by income and actual payments towards expenditure method of account keeping being restricted to the account keeping in connection with professional man's account. In mercantile accounting system, the element of bad debt particularly comes in and here they are allowed to be deducted during the year in which the bad debt actually occurs, from the book profits of that year. This is because in mercantile system the book profits are arrived at mainly on the basis of sales, purchases and expenses. In case of sales, whether on credit or for cash, the whole amount is taken into account and thus the book profits include amounts which are not yet received from the sundry debtors to whom the sales were made. When however, during subsequent years some of these debtors fail to pay and their debts become bad debts, it is but natural that from the book profits of the year concerned at the time of assessment, all bad debts incurred in the same year with respect to sales, either of the same year or prior year, must be allowed as deductions and are so allowed by the income tax authorities. A debt which has become legally irrecoverable is not conclusive evidence that it is actually irrecoverable or bad for the simple reason that among businessmen it may be still paid with dominant idea of maintaining one's credit. Thus the income tax authorities require to be satisfied that such a debt is really bad and irrecoverable before they allow same as a deduction. In case of a loan as distinct from the trade debt in connection with selling of goods, if it has become legally irrecoverable it is allowed to be ordinarily treated as actually irrecoverable. It may be however pointed out that the premia received by a company on issue of shares are capital receipts and as such they are not chargeable to tax. On the same footing the cost of issuing shares is capital expenditure and cannot be allowed as deduction for income-tax purposes.

Deductions and Allowances from Gross Profits

Of course the principal deduction or expenditure in any business is rent paid on business premises occupied by the company or business. If however the premises are also occupied by the owner of the business or his officers, only that much rent which the income tax officer considers as having been paid in connection with business will be allowed as a deduction. When however the premises are owned by the company itself, no allowance on account of rent is permissible because here the owner is not liable to pay tax on the annual value of these premises as provided for under Sec. 9. Here however the assessee is allowed a deduction for the amount spent on repairs each year on the portion of the premises used for the purposes of the business under Sec. 10 (2) (v) and where he is the tenant of the premises he is under Sec. 10 (2) (ii) allowed the amount expended by him on repairs if his lease require him to execute the repair. Where the premises are used partly for business and partly for residence the proportionate expenditure on repairs is permitted.

With respect to capital which is borrowed for the purpose of the business the amount of interest payable on it will be allowed provided the payment of such interest is not in any way dependent on the earnings of profit. Here it should be remembered that a loan can be borrowed on the ground of paying a fixed interest whether the borrower makes a profit or not and also arrangements are made with the lender to the effect that in lieu of interest he receives a share of profit when made and that in case there are no profits nothing is paid. In the last case no allowance is made. A company is entitled to allowance on interest paid by it on its debentures.

If the property of the company is insured against risk of damage or destruction of buildings, machinery, plants, furniture, stocks or stores used for the purpose of business, the amount of the premium paid is allowed in deduction. This means insurance for the benefit of

the business whose profits or gains are being calculated for the purposes of the tax. If however sums are not actually spent on premium, but are merely set aside by a company as an insurance fund, it becomes a sort of reserve and no allowance or deduction is given in respect of such reserves. The Act does not contemplate the deduction of premium on account of insurance against the losses of profit but the Income Tax Manual, 5th Edition, page 183, para 45, lays down as under :—

"If, however, the owner of a business elects to claim any such allowance, he should signify his intention to the Income-tax Officer—and if he makes a declaration in writing, undertaking generally to pay the tax on any amounts recovered from an Insurance Company under any such policy or policies, the allowance will be granted in respect of the premia for any such policies that he may have taken out not more than a month before the date of such declaration or that he may take out subsequent thereto. Where no allowance is asked or allowed in respect of such policy, any sums received from the Insurance Company on account of the policy will not be liable to tax."

The expenditure with respect to current repairs to buildings, machinery, plant or furniture is allowed.

Besides this, depreciation of buildings, machinery, plants or furniture which is the property of the company which is assessed is also allowed according to the percentage laid down by the Income Tax Authorities on the original cost thereof. A regular table is laid down in the Income Tax rules with respect to these machineries, etc., which are as follows :—

Rule 8. An allowance under Sec. 10 (*2*) (*vi*) of the Act in respect of depreciation of buildings, machinery, plant or furniture shall be made in accordance with the following statement :—

Class of buildings, machinery, plant or furniture.	Rate.	Remarks.
	Percentage on prime cost.	
1. Buildings—		Double these rates may be allowed for buildings used in industries which cause special deterioration such as chemical works, soap and candle works, paper mills, and tanneries.
(1) First class substantial buildings of selected materials ..	2½	
(2) Buildings of less substantial construction	5	
(3) Purely temporary erections such as wooden structures	10	
2. Machinery, Plant or Furniture— General Rate	5	The special rates for electrical machinery specified hereinafter may be adopted, at the option of the assessee for that portion of the machinery.
Special rates are sanctioned as under in the following cases :—		
A. Plant and machinery used in		
(1) Flour Mills, Rice Mills, Sugar Works, Distilleries, Ice Factories, Aerating Gas Factories, Match Factories ..	6¼	
(2) Paper Mills, Ship Building and Engineering Works, Iron and Brass Foundaries, Aluminium Factories, Electrical Engineering Works, Motor Car Repairing Works, Galvanizing Works, Patent Stone Works, Oil Extraction Factories, Chemical Works, Soap and Candle Works, Lime Works, Saw Mills, Dyeing and Bleaching Works, Cement Works using rotary kilns, Rod Mills ..	7½	

Class of buildings, machinery, plant or furniture.	Rate.	Remarks.
	Percentage on prime cost.	
(3) Brick manufacture, tile-making industry, the manufacture of (*a*) vegetable ghee, (*b*) optical instruments, (*c*) coke and (*d*) concrete pipes, glass factories, Telephone Companies, Mines and Quarries, Wire and Nail making Mills	10	
B. Furniture and Plant in hotels and boarding houses ..	7½	
C.(1) Comptometers, Typewriters, Tube-well boring plant, concrete pile driving machines	10	
(2) Sewing and knitting machines employed in hosiery factories	10	
(3) Sewing machines for canvas or leather	12½	
(4) Motor cars used solely for the purpose of business ..	15	
(5) Indigenous sugar-cane crushers (Kohlus or Belans) ..	15	
(6) Moulds used in the manufacture of concrete pipes ..	16	
(7) Motor taxies, motor lorries and motor buses ..	20	
(8) Ropeway ropes and trestle sheaves and connected parts	25	
D. Ropeway structures—		
(1) Trestle and station steel work	5	
(2) Driving and tension gearing	7½	
(3) Carriers	10	
E. Salt Works—		
(1) Machinery, plant locomotives, wagons and rolling stock	10	
(2) Tugs, barges, motor launches and floating plant ..	7½	
(3) General plant and machinery used in engineering shops ..	7½	

Class of buildings, machinery, plant or furniture.	Rate.	Remarks.
	Percentage on prime cost.	
(4) Reservoirs, condensers, salt pans, delivery channels and piers, if constructed of masonry, concrete cement, asphalt or similar materials	5	
NOTE :—Repairs to earth works of the same kind will be allowed as revenue expenditure.		
(5) Piers, queys and jetties constructed entirely or mainly of steel	5	
(6) Piers, quays and jetties constructed entirely or mainly of wood	10	
(7) Pipe lines for conveying brine if constructed of masonry, concrete, cement, asphalt or similar materials	10	
3. Electrical Machinery—		
(a) Batteries	15	
(b) Other electrical machinery, including electrical generators, motors, (other than tramway motors), switchgear and instruments transformers and other stationery plant and wiring and fittings of electric light and fan installations	7½	
(c) Underground cables and wires	6	
(d) Overhead cables and wires ..	2½	
(e) X-Ray and Electro-Therapeutic apparatus and accessories thereto	20	
(f) Silk manufacturing, Weaving Machinery worked by electric motors including winding machines, twisting frames, doubling machine, pirn winding machine, warping machine, looms,		

Class of buildings, machinery, plant or furniture.	Rate.	Remarks.
	Percentage on prime cost.	
stentering machine and hydro-extractor ..	7½	
(g) Air-conditioning machinery	7½	
(h) Machinery used in the production of cinematograph films, namely :— Recording equipment, Reproducing equipment, Developing machines, Printing machines, Editing machines, Synchronisers and Studio lights	15	
4. Hydro-Electric Concerns— Hydraulic Works, pipe lines, sluices, and all other items not otherwise provided for in this statement	2½	
5. Electric Tramways—Permanent Way—		
(a) Not exceeding 50,000 car miles per mile of track per annum	6½	
(b) Exceeding 50,000 and not exceeding 75,000 car miles per mile of track per annum ..	7½	
(c) Exceeding 75,000 and not exceeding 125,000 car miles per mile of track per annum	8½	
Cars—car tracks, car bodies, electrical equipment and motors	7	
General plant, machinery and tools	5	
6. Mineral Oil Concerns—		
A. Refineries—		
(1) Boilers	10	
(2) Prime movers	5	
(3) Process plant .. .	10	
B. Field operations—		
(1) Boilers	10	
(2) Prime movers	5	
(3) Process plant	7½	

Class of buildings, machinery, plant or furniture.	Rate.	Remarks.
	Percentage on prime cost.	
Except for the following items—		
(1) Below ground	100	
(2) Above ground—		
(*a*) Portable boilers, drilling tools, wellhead tank, rigs, etc.	25	
(*b*) Storage tanks ..	10	
(*c*) Pipe lines—		
(*i*) Fixed boilers ..	10	
(*ii*) Prime movers ..	7½	
(*iii*) Pipe line ..	10	
7. Ships—		
(1) Ocean—		
(*a*) Steam	5	
(*b*) Sail or tug	4	
(2) Inland—		
(*a*) Steamers (over 120 ft. in length)	5	
(*b*) Steamers including cargo launches (120 ft. in length and under) ..	6	
(*c*) Tug boats	7½	
(*d*) Iron or steel flats for cargo, etc.	5	
(*e*) Wooden cargo boats up to 50 tons capacity ..	10	
(*f*) Wooden cargo boats over 50 tons capacity ..	7½	
(*g*) Motor launches ..	10	* "Speed Boats" means a motor driven boat with a high speed internal combustion engine capable of propelling the board at a speed exceeding 15 miles per hour in still water and so designed that when running at speed it will plane, *i.e.*, its bow will rise from the water.
(*h*) Speed boats* ..		

Class of buildings, machinery, plant or furniture.	Rate.	Remarks.
	Percentage on prime cost.	
8. Mines and Quarries—		
(1) Railway sidings* excluding rails	5	*Depreciation on rails used for tramways and sidings, and in inclines where the rails are the property of the assessee, is allowed at 10 per cent. under item 2 above (plant used in connection with Mines and Quarries) in addition to any depreciation allowance on the cost of constructing the tramways sidings or inclines.
(2) Shafts	5	
(3) Inclines*	5	
(4) Tramways on the surface* (excluding rails) ..	10	
9. Aeroplanes—		
(1) Aircraft	25	
(2) Aero-engines	33⅓	
(3) Aerial photographic apparatus	20	

Rule 8A. Allowances under Sec. 11(*2*) (*ii*) of the Act in respect of depreciation of buildings, machinery, plant or furniture shall be in accordance with the rates prescribed in the statement attached to Rule 8; and in respect of apparatus, appliances or other capital assets not covered by that statement, the allowance shall be at the rate of 5 per cent. per annum on the prime cost.

I,............declare that to the best of my information and belief the buildings, machinery, plant and furniture described in column 1 of the above statement were the property of............ during the year ended............and that the particulars entered in the statement are correct and complete.

Place Signature

Date Designation

In connection with the above table it should be noted that no allowance can be claimed on account of depreciation, *e.g.*, of any portion of a building which is used as a residence by the assessee and that building should be the property of the assessee and that no allowance will be given if they are leased from others. If however the buildings belong to the owner of a business and are used for the purposes of housing employees they are treated as buildings for the purposes of business in case the owner charges no rent. In a Madras High Court case, *viz.*, *Commissioner of Income Tax, Madras* v. *Messrs. Massey & Co. Ltd.*, (1929) *Mad.* 453; 56 *M. L. J.* 461; 3 *I. T. C.* 302 it is ruled that a successor to a business has a right to carry forward for the purposes of assessment the unexhausted depreciation allowance in respect of the buildings, machinery, plants, etc., due to its predecessors in the year previous to the succession. We have also seen that depreciation is calculated in case of machinery on the "original cost." This original cost includes cost of freight, pay of engineer and staff who erect the machine and put it in working order as well as of cost of experiments to test same in addition to the cost of machinery and thus on this total cost the percentage of depreciation would be calculated and allowed. It happens that there are no profits on which the depreciation charged could be deducted for the current year in which case the said depreciation charged will be allowed to be carried forward to be taken during any subsequent year into the account of profits in addition to the current year's depreciation. If the assessee or company owns more than one business the allowance in connection with depreciation of one business where there are no profits and which cannot be set off against them may be deducted and set off, if possible, against the profits of the same year on any other business or business owned by the assessee. When the depreciation of furniture is allowed the cost of replacement is not allowed.

Depreciation on Shares and Securities

In connection with shares and securities held by the business as part of the company's capital, any depreciation or appreciation in their market value is outside the scope of the Income Tax Act. Thus when the value of securities held as a reserve fund of a bank or other company, rise and are realised, the transaction is a capital transaction and no account is taken for income tax purposes of any profits or losses resulting from the same. If however where a company habitually uses part of its reserves in purchase and sale of securities with a view to obtaining profits on them and the subsequent investment of the proceeds, the company is carrying on trade for the purpose of obtaining profit in security and is thus liable to tax on such profits and thus the profits or losses will be taken into account in determining the assessable income.

Obsolation allowance on Machinery

Besides the above in case of assets such as machinery or plants when they become obsolete, an obsolation allowance is given, but in case such machinery or plant is sold for reasons other than obsolation, no allowance is of course given. The calculation of allowance of obsolation is made on the original cost to the owner and the allowances on the footing of the amount on such original cost to the owner as reduced by the depreciation allowance under Sec. 10 (2) (vi) and the amount for which the machine is actually sold or its scrap value. The Income Tax Manual on page 187, para 47 gives an example to illustrate this rule to the effect that :—

"For example a machine costing Rs. 10,000 on which a depreciation allowance of 10 per cent. of the original cost is admissible is sold after 5 years for Rs. 2,000. The original owner gets Rs. 5,000 for depreciation and nothing for obsolescence as the machine is not scrapped or sold on account of obsolescence. The second owner gets also an allowance at the rate of 10 per cent., and as the cost of the machine to him was Rs. 2,000, his annual allowance is Rs. 200. If owing to its becoming out of date the machine is scrapped as useless after three years, then

in the year in which it is so scrapped the second owner can claim Rs. 1,400 for obsolescence. No allowance for obsolescence is obviously permissible if the machine lasts 10 years or more *with any one owner*. This will apply also where, the "second owner" is not merely a purchaser but a "successor" to the business of his predecessor to which the machine originally belonged.

Live Stock

Allowance is also given in respect of live-stock belonging to the company's business, that has died or become permanently useless to the assessee whether such live stocks are replaced or not.

Local Rates, &c.

On the same footing allowances are made for sums paid on account of land revenue, local rates or municipal taxes with respect to the business or premises used for the purposes of business. The local rate of tax which is payable irrespective of whether the profits are made or not are treated as expenditure incurred solely for the purpose of earning profits or gains and no allowance is given on account of any other rates or taxes whatsoever.

Bonus to employees

Expenditure by way of amount paid to employees as bonus or commission for services rendered are allowed provided that the amount so paid is reasonable with reference to his pay and conditions of service, the profits of business for the year in question and the general practice in similar business.

Other expenses

There is also a general sub-clause to Sec. 10 providing for any expenditure which is not in the nature of capital expenditure and which is incurred solely for the purpose of earning such profits or gains. This means miscellaneous business expenses and deductions. We have already dealt with bad debts in this connection. Under these deductions reserve for bad debts or provident fund or other funds

are not allowed as deductions, neither are expenditures in the nature of charity or present or in the nature of capital cost of additions, alterations, extensions or improvements of any of the assets of the business nor sums paid on account of income tax or super-tax in India or elsewhere or any tax levied by any authority other than land revenue, local rates or municipal taxes in respect of the portion of the premises which is used for the purposes of business. Losses sustained in former years are also not allowed, nor are the losses recoverable under an insurance or a contract of indemnity. In case of depreciations of assets also only those depreciations which are allowed under Sec. 10 (2) (vi) are allowed. No expenditure generally speaking of any kind which is not incurred solely for the purpose of earning profits is allowed.

Unrecoverable loans

In case of bankers and finance societies carrying on money lending business, loans which cannot be recovered should be deducted from the assessed profits of such business at the time when such loans can be definitely proved to be irrecoverable. In this connection the example cited and the instructions laid down in para 41, page 180 of the Income Tax Manual are as follows :—

"For example, if a banker has lent out 5 lakhs of rupees and received Rs. 50,000 as interest but has during the same year lost an irrecoverable loan of Rs. 25,000, he should be assessed on Rs. 25,000. Similarly, if the same banker receiving Rs. 50,000 as interest on his loans suffers a loss of an irrecoverable loan amounting to one lakh during the same year, the income to be assessed to income-tax from the money-lending business in that year will be nil. These examples will apply whether the assessee had previously been assessed to income-tax or not.

This instruction will also apply to the assessment of other traders, where loans have been made in connection with the business and in which the loans are of the nature of the business and the loss is a true trading loss.

The irrecoverable loans in the sense referred to in this paragraph are sometimes confused with the "bad debts" described in paragraph 37, but they are of a totally different nature. Money

lent out on interest is the stock-in-trade of a money-lender or banker and the loss of such stock-in-trade can clearly be regarded as a trading loss like the loss of the stock-in-trade of any other trader where the loss is not covered by insurance. In settling claims of this nature the question has always to be considered whether money-lending is, or is not, a part of the business of the trader in question. The investment of savings or occasional loans made to acquaintances cannot be considered to be loans made in the course of trading."

In connection with bad debts we have to see that company let out a factory or mill to other persons who worked it. It was held that the assessee used the factory for the purpose of business, not of working it but of leasing it and therefore the deduction for depreciation was allowed (*In Commissioner of Income Tax* v. *Mangalagiri Shree Uma Maheswara Gin and Rice Factory,* (1926) 50 *Mad.* 529; 2 *I. T. C.* 251).

BAD DEBTS

In connection with bad debts we have to seen that whether a debt is bad is a question of fact. In a latest Privy Council case, *viz.*, the *Commissioner of Income Tax, Central Provinces* v. *Sir S. M. Chitnavis,* (1932) *Bom. L. R.* 1071, the question came up and it was decided that whether a debt is a bad debt, and, if so at what point of time it became a bad debt, the questions of fact to be determined in the event of dispute, is not by the *ipse dixit* of the assessee or by the exercise of any so-called option on his part, but by an appropriate tribunal upon the consideration of all relevant and admissible evidence. It was also laid down here that though bad debts are necessarily deductible while assessing to income tax the amounts of profits and gains, they must be bad debts incurred in that particular year, because for the purpose of computing yearly profits or gains each year is a separate self-contained period of time incurred to which profits earned or losses sustained before the commencement of the year are irrelevant. It has also been held that bad debts ought

to be written off within a reasonable time and that it is not for the assessee to determine when he should write off bad debt (*The Commissioner of Income Tax* v. *Vallabhdas Murlidhar*, (1930) 32 *Bom. L. R.* 309, *see also in re. Bishnu Priya Chowdhurani*, (1923) 50 *Cal.* 907). There are cases where the assessee keeps regular suspense accounts for interest on bad and doubtful debts which if genuine cases in the opinion of the commissioner of income tax, the said officer does not insist on such interest being reckoned in taxable profits till the same was actually realised or otherwise adjusted.

Depreciation of Machinery

We have already seen above the rules of income tax practice as to allowance for depreciation of machinery. In a Bombay case it was held that a company while making its returns for the year 1922-23 on the basis of its income, profits and gains for the year ending June 30, 1921 were entitled to deduct an allowance for obsolescence as provided for in Sec. 10 (2) (vii) of the Indian Income Tax Act, 1922 (*In re. Raja Goculdas Mills Ltd.*, (1924) 26 *Bom. L. R.* 312). Where the business of a company is taken over by another person or company and the question of depreciation on building, machinery, plant or furniture so taken over arises under Sec. 10 (2) (vi) of the Indian Income Tax Act of 1922, the same has to be calculated on the original cost thereof to the assessee. Here the assessee would naturally be the person who has taken over the business and therefore the depreciation allowance under the above section would be calculated on the original case to the assessee who buys over and not to that of the previous owner from whom the assessee had purchased the business (*The Commissioner of Income Tax, Bombay* v. *Saraspur Mills Co. Ltd., Ahmedabad*, (1932) 56 *Bom.* 129).

Again the practice in connection with depreciation on machinery is that the original block of machinery and each block constituted by the year's addition are treated

as separate units on which depreciation should run independently, so that, each block would in course of time be eliminated one after the other as soon as its full value is written off. The depreciation is only allowed on machinery actually used in the business by the assessee company and not on one which is let or hired by it. This rule however does not apply to obsolescence and the allowance for this is made.

OBSERVATIONS ON EXPENSES

In connection with expenditure, as we have already seen, the principle involved is that before this expense can be claimed as a deduction it should be shown that the same was incurred for the purpose of earning profits. The expenses should be, of course, what are known as revenue expenses, as different from capital expense. Capital expenses are expenses which add to the assets, whereas revenue expenses are for the purpose of profits. The purchase of building or addition of a wing to it, or purchase and erection of machinery for the purpose of working same would be the instances of capital expenditure. In *Ammonia Soda Co.* v. *Chamberlain,* (1918) 1 *Ch. D.* 266 *Swinfen Eady, L. J.* has distinguished fixed capital from circulating capital. In this case his Lordship says that

"The distinction between "fixed" capital and "circulating" capital is not to be found in any of the Companies Acts; it appears to have first found its way into the Law Reports in *Lee* v. *Neuchatel Asphalte Co.,* (1889) 41 *Ch. D.* 1, where *Lindley, L. J.,* in his judgment adopted the expression which had been used by *Sir Horace Davey* in argument, derived from writers on political economy. It is necessary to consider the sense in which the expressions "fixed capital" and "circulating capital" were used in that case and in *Verner's Case,* (1894), 2 *Ch.* 239. What is fixed capital? That which a company retains in the shape of assets upon which the subscribed capital has been expended, and which assets either themselves produce income, independent of any further action by the company, or being retained by the company, are made use of to produce income or gain profits. A trust company formed to acquire and hold stocks, shares and securities, and, from time to

time, to divide the dividends and income arising therefrom, is an instance of the former. A manufacturing company acquiring or erecting works with machinery and plant is an instance of the latter. In these cases the capital is fixed in the sense of being invested in assets intended to be retained by the company more or less permanently and used in producing an income. What is circulating capital? It is a portion of the subscribed capital of the company intended to be used by being temporarily parted with and circulated in business, in the form of money, goods or other assets, and which, or the proceeds of which are intended to return to the company with an increment, and are intended to be used again and again, and to always return with some accretion. Thus the capital with which a trader buys goods circulates; he parts with it, and with the goods bought by it, intending to receive it back again with profit arising from the resale of the goods. A banker lending money to a customer parts with his money, and thus circulates it, hoping and intending to receive it back with interest. He retains, more or less permanently, bank premises in which the money invested become fixed capital. It must not however, be assumed that the division into which capital thus falls is permanent. The language is merely used to describe the purpose to which it is for the time being appropriated. Thus purpose may be changed as often as considered desirable, and as the constitution of the bank may allow. Thus bank premises may be sold, and conversely the money used as circulating capital may be expended in acquiring bank premises. The forms "fixed" and "circulating" are merely terms convenient for describing the purpose to which the capital is, for the time being, devoted when considering its position in respect to the profits available for dividend. Thus where circulating capital is expended in buying goods which are sold at a profit, or in buying raw materials from which goods are manufactured and sold at a profit, the amount so expended must be charged against, or deducted from *receipts*, *before* the amount of any profits can be arrived at. This is quite a truism, but it is necessary to bear it in mind when you are considering what part of current receipts are available for division as profit."

Thus expenses of litigation in *Secretary, Board of Revenue* v. *B. Muniswami Chetty*, (1924) 47 *Mad.* 653 were held to be not chargeable against revenue, though they were incurred for protecting profits from income tax assessment, for the simple reason that they were not incurred solely for the earning of profits. Thus it is practically speaking a question of fact as to how far a particular expenditure can be allocated to capital or revenue

and how far it could be claimed as an expenditure which is necessary for earning the profits. Embezzlement through or by the carelessness of an employee in course of business is allowed as a deduction, but not money lost through the person responsible for the business.

Underwriting Expenses, that is commission paid for underwriting shares issued by a new company or new shares issued by the old is not allowed to be deducted as an expenditure for the purpose of business for the purpose of income tax assessment (*In re. Tata Iron & Steel Co., Ltd.*, (1921) 23 *Bom. L. R.* 576). This is again on the same footing as we have seen above, *viz.*, that it does not relate to expenditure incurred solely for the purpose of earning profits, *viz.*, profits derived by the business carried on by the company. Here the expenditure was declared to be in the nature of capital expenditure. His Lordship cited two cases which must be considered of importance in connection with this question, *viz.*, *Texas Land and Mortgage Co.* v. *William Holtham,* (1894) 63 *L. J. Q. B.* 496 & *The Royal Insurance Co.* v. *Watson,* (1897) *A. C.* 1.

Insurance Expenses

In connection with this the usual practice of income tax authorities happens to be that under Sec. 10 (2) (iv) allowances are restricted to insurance policies taken out against the risk of damage or destruction of buildings, machinery, plant, furniture, stocks or stores used for the purposes of business of which the profits or gains are being calculated and assessed. If the practice is to set aside a certain amount and not actually pay it out by way of premium to outside companies, no allowance or deduction is allowed because the same are treated as ordinary reserves out of profits. The premium for policies against loss of profit is not in contemplation of the Income Tax Act, but the practice is that if a declaration is made in writing to the income tax officer that if this premium is allowed, the assessee undertakes to pay tax

on any amount recovered from insurance companies on such policies in case of loss, the same may be allowed. The same rule may apply most probably in case of premiums paid on the life of an employee where presumably the premiums may be claimed as a deduction under Sec. 10 (2) (ix) and where the policy falls due, the amount is received and the same will be treated as a profit of that year and taxed accordingly.

EXPENDITURE NOT IN THE NATURE OF CAPITAL EXPENDITURE

Expenditure which is not in the nature of capital expenditure incurred solely for the purposes of earning profits or gains is allowable as a deduction from the total profits provided that nothing in Clauses 8 and 9 shall be deemed to authorise the allowance of any sum paid on account of any cess, rate or tax levied on the profits or gains of any business or assessed at the proportion of or otherwise on the basis of any such profits or gains. In fact this wording in the proviso was specially introduced according to the statement of objects and reasons in the Indian Income-tax Amendment Act of 1928 (III of 1928) to bring about an alteration in law as enunciated in the *Isabella case.* Thus now any cess, rate or tax levied on the profits or gains of any business, or assessed at a proportion or otherwise on the basis of such profits or gains shall not be allowable under Clause 8 or Clause 9 of Sec. 10 (2).

We have already seen what is actually meant by expenditure as distinguished from revenue expenditure as understood on the general principles of accountancy business and mercantile practice. Generally speaking expenditure on fixed assets of a permanent nature which are used for the purpose of business would be capital expenditure, whereas expenditure such as payment of salary, advertisements, rent of business premises, warehouses, factories, etc., would be expenditure. The purchase of the goodwill of a business is of course a capital expenditure, so the purchase of a

patent right which is to be worked for the purposes of business. Each case would of course have to be considered on its own merits while answering the question whether a particular expenditure is of a capital or revenue nature. In these cases mere book-keeping entries are not conclusive (*Highland Rail Co.* v. *Special Commissioners,* (1885) 2 *T. C.* 151; *Doughty* v. *Commissioners of Taxes,* (1927) *A. C.* 327; *Inland Revenue Authorities* v. *Scottish Automobile, etc.,* (1932) *S. C.* 87).

Sec. 10 (2) (ix) no doubt overlaps some of the previous clauses, the only exceptions being depreciation and obsolescence. The question arises whether this clause is meant to be construed as applying to such expenditure as is not referred to in the preceding clauses and has been incurred for the purposes of carrying on the business and for earning the profits concerned or whether the same is to be taken and read along with the other clauses in the same section. This question has been answered in (*Ratan Singh* v. *Commissioner of Income-tax, Madras,* (1926) 2 *I. T. C.* 294). Here it was held that the allowance specified in Sec. 10 must be treated as disjunctive and cumulative and not alternative and exclusive and consequently, Sec. 10 (2) (vi) could not be construed as extinguishing the right to deductions specifically outlined and defined in other clauses of the section.

Capital and revenue expenditure or expenditure incurred solely for earning profits are terms which are "matters of practical convenience which is undoubtedly embodied in the generally understood principles of commercial accountancy" (*Roebank Printing Co.* v. *Commissioners of Inland Revenue,* (1928) *S. C.* 701; 13 *T. C.* 864). Where expenditure is incurred for acquisition of an asset, it is undoubtedly a capital expenditure (*Robert Addie & Sons Collieries Ltd.* v. *Commissioners of Inland Revenue,* (1924) *S. C.* 231; 8 *T. C.* 671; *at p.* 677; *Mallett* v. *Staveley Coal & Iron Co. Ltd.,* (1928) 2 *K. B.* 405; 13 *T. C.* 772). *Rowlatt, J.* put in that "the real test is whether expenditure is made to meet a continuous demand for expenditure

as opposed to an expenditure which is made once for all" (*Ounsworth* v. *Vickers Ltd.*, 6 *T. C.* 671). Another learned Judge supporting this view of *Rowlatt J.* stated that "capital expenditure is a thing that is going to be spent once and for all and income expenditure is a thing that is going to recur every year" (*Vallambrosa Rubber Co. Ltd.* v. *Farmer*, (1910) *S. C.* 519; 5 *T. C.* 529). Where a mine was closed down for a period and had to be reconditioned with a view to commence work, the expenditure was considered to be a capital expenditure and was not permitted to be deducted from the company's profits for the period as an expenditure incurred for earning the profits (*Naval Colliery Co. Ltd.* v. *Commissioners of Inland Revenue*, (1928) 136 *L. T. R.* 28; 138 *L. T. R.* 593; 12 *T. C.* 1017). Amount paid for restoring land of a colliery to an arable condition was held to be capital outlay (*R. Addie & Sons Collieries Ltd.* v. *C. I. R.*, (1924) *S. C.* 231; 8 *T. C.* 671). In case of the another colliery when payments were made to the lesser in consideration of accepting the surrender of a mining lease and a part of the area demised by another mining lease and released the company under its obligations under the second lease, were held to be sums paid as expenditure towards fixed capital and not expenditure incurred for the purpose of earning profits.

On the other hand money received for colliery dross which had been lying the estate for many years and was sold away was held not to be profits liable to income-tax (*Roberts* v. *Lord Belhaven's Executors*, (1925) *S. L. T.* 466; 9 *T. C.* 501). On the same principle cost of pit sinking, claims for exhaustion of a nitrate mine and that for deepening main shaft, were all declared to be capital losses (*Coltness Iron Co.* v. *Black*, (1881) 6 *A. C.* 315; *Alianza Co. Ltd.* v. *Bell*, (1906) *A. C.* 18; *Bonner* v. *Bassett Mines Ltd.*, (1912) 108 *L. T. R.* 764; 6 *T. C.* 146). Replacement of an entirely, as in the case of the cost of a new chimney in place of the old is not allowable as a deduction from the profits (*O'Grady* v. *Bullcroft Main Collieries Ltd.*, (1932) 17 *T. C.* 93). On the question as to whether a

particular expenditure is a capital or revenue expenditure is a question of fact, or of law there has been some conflict in the decisions of learned judges. Ultimately it is now laid down that the problem could be solved by stating that in some cases it may be determined as a question of fact, whereas on the other hand there are cases in which it is a mixed question of fact and law, and that, in all cases it is a question of law whether there was any evidence at all on which the conclusions reached by the Commissioners or by the Court can be sustained (*Morley* v. *Lawford & Co.*, (1928) 45 *T. L. R.* 30; 14 *T. C.* 229). Where one company, while purchasing another, provided in its agreement that the manager of the vending company should be taken into the services of the purchasing company, with the option that the purchasing company may commute the salary of the said manager by the payment of a gross sum and the said gross sum was paid by way of commutation of his annual salary, it was held that the said payment was part of the purchase-money and was thus a capital expenditure. It was emphasised that whether it was entirely or partly the purchase-money was perfectly immaterial (*Royal Insurance Co.* v. *Watson*, (1897) *A. C.* 1; 3 *T. C.* 500). The expenditure incurred in promotion of a Bill in Parliament for securing certain trade facilities was not allowed to be treated as revenue expenditure, but was declared to be clearly of a capital nature (*A. G. Moore & Co.* v. *Hare*, (1915) *S. C.* 91; 6 *T. C.* 572). The expenditure incurred by a business establishment for moving from one premises to another was not allowed to be deducted, because it was held to be an expenditure in the general interest of the business and not an expenditure incurred for the year in which the act was done (*Granite Supply Association Ltd.* v. *Kitton*, (1908) 8 *F.* 55; 5 *T. C.* 168). Expenditure for putting up a temporary premises while the old site of the business premises which was burnt down was being attended to, was held to be capital expenditure (*Martin Fitzgerald* v. *Commissioners of Inland Revenue*, 5 *A. T. C.* 419). When a shipping company contracted to buy a ship which

was to be constructed for it but before the ship could be got ready, they cancelled the contract due to adverse conditions of the market and finding that working of the ship would result in a loss and in consideration of this cancellation paid a large sum of money, the same was declared to be a capital expenditure and not allowed as a deduction from profits (*Countess Warwick Steamship Co. Ltd.* v. *Ogg*, (1924) 2 *K. B.* 292; 8 *T. C.* 652). A sum of money paid to a rival contractor to prevent him from competing in the securing of a certain contract was disallowed as it was a capital expenditure owing to the fact that the said expenditure was incurred for obtaining the contract and not for working same (*Rao Saheb A. S. Alaganan Chetty* v. *Commissioner of Income-tax, Madras,* (1928) 3 *I. T. C.* 44). In this case *Coutts Trotter, C. J.* cited a number of English decisions bearing on similar transactions before arriving at this conclusion, one of them was the case of the *Countess Warwick Ship Co.* v. *Ogg* which we have already quoted above. As the arguments is rather important it may be quoted as follows :—

The principles that apply are contained in the statute of course and are much illuminated in our opinion by two cases, one in the Court of Appeal and another in the House of Lords in England to which we shall refer and which seem to us to explain in the clearest possible way the distinction between capital payments and expenditure not being capital, where it is conceded that in every case the expenditure is incurred solely for the purpose of earning the profits. I have really read the material part of the Indian Statute. It is Section 10(*2*) (*ix*) : "(2) Such profits or gains shall be computed after making the following allowances" and the only one we are concerned with is sub-section (*ix*), "any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains." The first English case to which I propose to refer is a case of the *City of London Contract Corporation, Limited* v. *Styles*, (1881) 2 *T. C.* 239 in the Court of Appeal in 1887 before a very powerful Court consisting of *Lord Esher, Bowen, L. J.*, and *Fry, L. J.* The first passage I am going to read is an observation made by *Bowen, L. J.*, in the course of the argument and it appears to me to be as clear and sharp-cut a distinction as any to be found in the other cases. In that case the assessees took over a business of another company

which had a number of unexecuted contracts on hand and the taking over company paid a lump sum of money to the out-going company to obtain the benefit of those contracts and claimed it as a deduction. *Lord Justice Bowen* in the course of the argument said this :—"You do not use it (that is, the money which had bought the contractual rights) for the purpose of your concern, (which means 'for the purpose of carrying on your concern') but you use it to acquire the concern." Similarly *Lord Esher at page* 244. "Here is a clear statement that the difference between money expended in the year in order to earn income which was to be received in the year, and the income so received was £1,28,000. That is the net profit within the year, that is the sum upon which income-tax is to be paid; and it is as plain as can be that you cannot deduct from those net profits so arrived at any part of the capital which you so invested, whether you paid it or not for the purchase of the business which you were obliged to purchase before you could begin the difference between expenditure and income year by year. If you do not darken it with words, it is as plain as can be."

Now I pass to a case in the House of Lords, *John Smith & Sons* v. *Moore*, 12 *T. C.* 266; (1921) 2 *A. C.* 13. The facts I need not really go into because the passage I am going to cite from *Lord Sumner* is really what directly bears on this case. "They (the company) said, much as has been said in this case, that before profits can be made out of working a contract, the contract has to be got and the payment of its price is the root of the profits. The court held that this sum was paid with the rest of the aggregate price to acquire the business and thereafter profits were made in the business; the sum was not paid as an outlay in a business already acquired, in order to carry it on and to earn a profit out of this expense as an expense of carrying it on. The same is true of the appellants. The whole price paid, in cash or in account, was a sum employed or intended to be employed as capital in the trade of the company, and therefore cannot be deducted in ascertaining profits for income-tax or excess profits duty."

I only wish to refer just in passing to one other case which is the case of the ship-builder and the buying of all the contracts, (*Countess of Warwick Steamship Co.* v. *Ogg*, 8 *T. C.* 652). It is the judgment of a single judge but it is a judgment of *Rowlatt, J.*, a very great authority in income-tax cases in which he has specialised for so many years. I will not quote his language but the short point was this. The Steamship Company in question had arranged for the purchase of a steamship on the very common system whereby the ship-builders are paid a lump sum in part payment as soon as the keel is laid in the yard and the rest of the price is paid in instalments as the fabric is gradually built up.

After about £30,000 had been paid to the ship-builders which a very small portion of all that would ultimately have to be paid there was a slump in freights and the owners came to the conclusion that it would be impossible for them to carry on the business of running this ship as a freight-earning ship at any profit whatever and they therefore sought to get out of the liability for paying for a thing that in their hands would be perfectly useless. The £30,000 of course was gone but in order to get out of the contract they had to pay another £30,000 and the argument that found favour was that this was not a loss which could be brought into the profit and loss account, because although it is difficult to say, it resulted in any increase of capital or plant in the nature of capital to the ship-builders, it was incurred in relation to that part of their business.

Replacement of old editions of books by new editions in a lawyer's library is a capital expenditure and not an allowable deduction (*Sir Hari Singh Gour* v. *Commissioner of Income-tax, C. P.,* (1928). 3 *I. T. C.* 333). Price paid for unexecuted contracts by a company which purchased part of the business of another Company was a capital expenditure (*City of London Corporation* v. *Styles,* (1887) 2 *T. C.* 239; *See also John Smith & Sons* v. *Moore,* (1921) 2 *A. C.* 13). In this case the father of the assessee who carried on business as a shipping and coal agent left the property to the assessee on a condition that he should take them over at a valuation without paying anything for goodwill. These assets included certain forward coal contracts made by the father with various colliery agents. The contracts were valued at £30,000 and turned out to be very advantageous to the assessee. The assessee claimed that in arriving at the amount of the profits of business chargeable to excess profits duty the amount of £30,000 as representing part of purchase price of the stock-in-trade should be deducted. It was heid by a very strong Board of the House of Lords made up of Lords Haldane, Cave Finlay and Summer, by majority that the deduction was not permissible. Lord Haldane and Lord Summer held that the purchase was a capital expenditure whereas Lord Cave held that the Excess Profits Duty was a tax on a continuous business and for the purpose of the appeal,

the change of ownership should be disregarded. Lord Finlay dissented. *Lord Haldane* on page 19 in his judgement justified his decision on the following ground :—

"My Lords, profit may be produced in two ways. It may result from purchases on income account, the cost of which is debited to that account, and the price realized therefrom are credited, or it may result from realization at a profit of assets forming part of the concern. In such a case a prudent man of business will no doubt debit to profit and loss the value of capital assets realized, and take credit only for the balance. But what was the nature of what the appellant here had to deal with? He had bought as part of the capital of the business his father's contracts. These enabled him to purchase coal from the colliery owners at what we were told was a very advantageous price, about fourteen shillings per ton. He was able to buy at this price because the right to do so was part of the assets of the business. Was it circulating capital?

My Lords, it is not necessary to draw an exact line of demarcation between fixed and circulating capital. Since Adam Smith drew the distinction in the Second Book of his Wealth of Nations, which appears in the chapter on the Division of Stock, a distinction which has since become classical, economists have never been able to define much more precisely what the line of demarcation is. Adam Smith described fixed capital as what the owner turns to profit by keeping it in his own possession, circulating capital as what he makes profit of by parting with it and letting it change masters. The latter capital circulates in this sense.

My Lords, in the case before us the appellant, of course, made profit with circulating capital by buying coal under the contracts he had acquired from his father's estate at the stipulated price of fourteen shillings and reselling it for more, but he was able to do this simply because he had acquired, among other assets of his business, including the goodwill, the contracts in question. It was not by selling these contracts, of limited duration though they were, it was not by parting with them to other masters, but by retaining them, that he was able to employ his circulating capital in buying under them. I am accordingly of opinion that although they may have been of short duration, they were none the less part of his fixed capital."

It will be seen above that the ground on which His Lordship arrived at this conclusion was that the contracts which the assessee had purchased were used as a sort of fixed assets, because the assessee was not making profits

by selling the contracts but by retaining them. Lord Cave put the case in his own way as follows on pages 34-35 on slightly different grounds :—

"If the profits which are to be considered are the profits derived from the trading operations of the continuing firm of John Smith & Son, however constituted, then the expenses to be deducted are those, and those only, which were incurred in the course of those trading operations; and it is plain that the £30,000 deduction of which is claimed, does not fall within that description. It was wholly unnecessary for any trading purpose of the business (regarded as a continuing concern) that £30,000 or any other sum should be paid for the coal contracts; for those contracts belonged to the firm from the time when they were entered into. The £30,000 was not paid by the firm for coal nor was it paid by the trading firm as such for coal contracts; it was paid by John Ross Smith out of his private pocket as part of an overhead transaction under which the business with its assets and future profits passed into his hands, and it left the trading profits of the firm unaltered.

If I buy the crop of an orchard in a particular year for 20sh. and sell it for 40*shs.*, my profit is only 20*shs.* But the profit of the orchard is 40*shs.*; and in comparing the produce of the orchard in that year with its produce in another year, it is the 40*shs.* and not the 20*shs.* that must be taken into account.

I may add that the contrary view would lead to strange results. If John Smith, junior, had lived until the end of 1915, it is clear that he would have earned the profits assessed and would have had to pay the duty claimed."

The above decisions have been influenced by the rule, *viz.*, that the expenditure incurred which is allowable should not be in the nature of capital expenditure as laid down in Sec. 10 (2) (ix) of our Indian Act whose exact wording is "that expenditure incurred for the purpose of earning profits or gains and which is not in the nature of capital expenditure is allowable." The case in point in which this principle can be very clearly noticed is that of the (*Mahalakshmi Textile Mills Ltd.* v. *Commissioner of Income-tax, Madras*, (1932) 6 *I. T. C.* 83). Here the company was started for the principal purpose of working as a Spinning and Weaving Mill and under its memorandum of association it was also authorised to accumulate

funds and invest them. The Company did not start its spinning and weaving business for some time, but in the interval the company accumulated funds in investments and received interest thereon. On assessment the company claimed that from this interest received on investments it should be allowed a deduction of the expenditure incurred by it in the purchase and erection of buildings, machinery and plant and in payment of managing agency remuneration as well as other office expenses. The Court held that the company was entitled to deduct only such expenditure as was incurred for earning interest through investment of the company's funds which was a legitimate part of its business activities and that the other expenditure was not allowable. Thus what is necessary is to see whether the expenditure incurred is of a nature, is incurred in earning the income on which the tax is being levied (*Atherton* v. *British Insulated & Holsby Cables Ltd.*, (1926) *A. C.* 205; 10 *T. C.* 155; *Usher's Wiltshire Brewery Ltd.* v. *Bruce*, 6 *T. C.* 399; (1915) *A. C.* 433; *Also see Morley* v. *Lawford & Co.*, (1928) 45 *L. T. R.* 30; 14 *T. C.* 229).

Expenses for maintaining a motor by a lawyer were not permitted to be debited to his income or gains as it was not possible to decide whether the said car was maintained for the purpose of his profession or business (*Dr. Sir Hari Singh Gour* v. *Commissioner of Income-tax, C. P. and Berar*, (1928) 3 *I. T. C.* 333).

Fees paid to accountants and lawyers by the assessee for helping him in the dispute with the Government as to the excess profits duty being due from him, or not, were not allowable as a deduction because they were not incurred for the purpose of earning profits or gains of his business (*Board of Revenue* v. *Muniswami Chetty & Sons*, (1923) 1 *I. T. C.* 227; (1924) 47 *Mad.* 653). A circus owner is entitled to deduct the moving expenses from the computation of his profits (*Eastman Ltd.* v. *Shaw*, (1928) 14 *T. C.* 218). An architect who bought shares in a company for which he acted as an architect, in order to secure from the company his employment as such and thereafter sold the

shares at a loss was not allowed to deduct the loss from his income, profits and gains (*Stott* v. *Hoddinott*, (1916) 7 *T. C.* 85). This was held by the Court to be a capital loss. Expenditure incurred on defective gas works in order to put them in a proper condition is a capital expenditure (*Clayton* v. *Newcastle-under-Lyme Corporation*, (1888) 2 *T. C.* 416).

An advance of money to a subsidiary formed for the purpose of supplying certain commodity which the parent company wanted was in case of the subsidiary going into liquidation held not to be a revenue loss but a capital loss (*English Crown Spelter Co.* v. *Baker*, (1908) 5 *T. C.* 327; *Also see Jacobs Young & Co.* v. *Harries*, 5 *A. T. C.* 735). Where however loans were granted by a Brewery Company on the security of their public houses and when the loans were not repaid and the security was enforced by sale and lossess incurred, because the value obtained on such sale was less than the amount lent, the said losses by way of bad debts were allowed to be deducted as incurred in case of business (*Watney* v. *Musgrave*, (1880) 1 *T. C.* 272). Pensions and gratuities granted by a business which was closed down were not allowed because they were not payments for the purpose of carrying on the company's trade (*Commissioners of Inland Revenue* v. *Anglo-Brewing Co. Ltd.*, 12 *T. C.* 803). Contributions to a Trade Protection Assiciation was allowed as a revenue expenditure (*Guest, Keen & Nettlefolds Ltd.* v. *Fowler*, 5 *T. C.* 511; (1910) 1 *K. B.* 713). Lump sums received by a cemetery company in computation of annual charges payable to them and invested by them as capital were not profits for assessment (*Paisley Cemetery Co.* v. *Reith*, (1928) 4 *T. C.* 1).

Penalties paid to the customs authorities were disallowed as not arising out of trade (*Commissioners of Inland Revenue* v. *E. C. Warnes & Co. Ltd.*, 12 *T. C.* 227). Sinking Fund created out of profits for the purpose of paying out the mortgage debt is not a deductible expenditure from assessable profits (*City of Dublin Steam Packet* v. *O'Brien*, (1912) 6 *T. C.* 101). Anticipated

losses on a breach of contract cannot be deducted until the losses have actually crystallised (*Edwards Collins & Sons, Ltd.* v. *Commissioners of Inland Revenue,* (1925) 12 *T. C.* 773; *see also Whimster & Co.* v. *Commissioners of Inland Revenue,* (1928) 12 *T. C.* 813).

The value of the coal exhausted in a mine can have no allowance (*Inland Revenue* v. *Farie,* (1878), 6 *R.* 270). No deductions are allowed for the price of oil not yet won, nor for the purchase price representing the cost of oil won in any one year (*Uses* v. *British Burma Petroleum Co. Ltd.,* (1932) 17 *T. C.* 286), because that would be on the basis of annual exhaustion of the natural deposits of a mine or an oil well (*Alianza Co. Ltd.* v. *Bell,* (1905) 1 *K. B.* 184; (1906) *A. C.* 18; *Kauri Timber Co.* v. *Commissioners of Taxes, New Zealand,* (1913) *A. C.* 777). Payment made in consideration of being allowed to surrender a mining lease which was found to be unprofitable is not allowable as a deduction (*Mallett* v. *Staveley Coal & Iron Co.,* (1928) 2 *K. B.* 405). Payment made for dumping ground or for damage to surface land by dumping subsidence, etc., are not allowable (*Inland Revenue* v. *Adam,* (1928) *S. C.* 738; *Addie's Collieries Ltd.* v. *Inland Revenue,* (1924) *S. C.* 231; 8 *T. C.* 671). A reserve fund specially created to replace buildings and plants is not allowable (*Forder* v. *Handyside,* (1876) 1 *Ex. D.* 233). In case of multiple shops, expenditure on fixtures and fittings for the new shop is not allowable (*Eastman's Ltd.* v. *Shaw,* (1928) 45 *T. L. R.* 12; *Hyam* v. *Inland Revenue,* (1929) *S. C.* 384). In case of a rubber estate expenses of cultivating and managing incurred in the year of assessment to develop it were allowable, though a part of those expenses produced no return in the year of assessment, but the expenses of clearing and draining the estate were not allowed because they were capital expenditure (*Vallambrosa Rubber Co., Ltd.* v. *Farmer* (1910) *S. C.* 519; *See also Marlimau Rubber Estates Ltd.* v. *Inland Revenue,* (1923) *A. C.* 283). Where a trader in return for having constructed siding at

his own expense was allowed rebates on freights on his own goods, the rebates allowed were calculated as trading receipts and not as capital receipts (*Westcombe* v. *Hadnock Quarries Ltd.*, (1931) 16 *T. C.* 137). Payment made to a foreign government for the concession of issuing notes was a capital expenditure and not deductible from the revenue (*London Bank of Mexico* v. *Apthorpe,* (1891) 1 *Q. B.* 383, *confirmed in* (1891) 2 *Q. B.* 378). Where a railway was constructed under government guarantee of 7 per cent. and the company raised debentures of 5½ per cent., the company however devoted 7 per cent. to the payment of this debenture interest and to the formation of a sinking fund for the repayment of the said debenture, it was held that notwithstanding the whole of the guaranteed payments during construction, was liable to pay income-tax under the heading of interest (*Blake* v. *Imperial Brazilian Railway,* (1884) 2 *T. C.* 58). A company which was formed through the purchase of a business by appointing the vendor as a managing director and paying him as purchase price a large quantity of shares, could not claim the dividend paid on the shares paid to the said managing director being computed as part of his remuneration, and deducted from the company's assessable profits (*Eyres* v. *Finnieston Engineering Co.,* (1916) 7 *T. C.* 74). Loans advanced by a law agent who acted for the company cannot be considered as an expenditure if they became bad debts (*Hagart & Burn-Murdoch* v. *Inland Revenue,* (1929) *A. C.* 386). Expenditure incurred on application for the reduction of capital by a company is not a deduction from profits (*Archibald Thompson Ltd.* v. *Inland Revenue,* (1919) *S. C.* 289; 7 *T. C.* 158). A bonus paid according to agreement on repayment of loan in addition to interest is not allowable expenditure (*Arizona Copper Co.* v. *Smiles,* (1891) 19 *R.* 15; 3 *T. C.* 149). The expenses of re-building of a business premises burnt down by rebels which was irrecoverable from insurance company is a capital expenditure and therefore is not an admissible deduction (*Martin*

Fitzgerald v. *Commissioners of Inland Revenue,* 5 *A. T. C.* 419). The replacement of fans and fittings by an electric company at its own cost when it converted direct current to alternating current, was expenditure of a capital nature and therefore not allowable as a deduction (*Nagpur Electric Light & Power Co. Ltd.* v. *Commissioners of Income-tax, C. P. & Berar,* (1932) 6 *I. T. C.* 303). Annual interest or other annual payments such as annuity if paid as a necessary expense for earning the profits are allowable because they cannot be claimed to be payable out of profits as in the case of income-tax (*Gresham Life Assurance Co.* v. *Styles,* (1892) *A. C.* 309). Here the life assurance company in consideration of being paid a lump sum premium granted as annuity and wanted to deduct the said annuity payments from its gross income which deduction was upheld by the court. In the course of his judgment Lord Balsbury pointed out that the income-tax act levied a duty on profits arising from property, professions and trades and offices and if the annuities or annual payments were payable out of the profits or gains, he held that no rule formulated under the act could prevent the deduction of such payments from the gross profits or gains on the business. He pointed out that an annuity seller, such as this business was, could not be treated differently from a seller of any ordinary article of commerce, such as cereals or corn or the like, but as long as these amounts were paid out of profits and gains the assessee was entitled to deduct them from his assessable profits for the purpose of income-tax. Interest paid on a bank overdraft is an item which can be deducted as if it is paid in the regular course of business from which the profit arose (*Scottish North American Trust Ltd.* v. *Farmer,* (1912) 5 *T. C.* 693). If however amount is borrowed for the convenience of one partner in a firm and not for the necessities of the business as a whole, it will not be allowed as a deduction from the firm's profits (*Anglo-Continental Guano Works* v. *Bell,* (1894) 3 *T. C.* 239) Breaker's fees and commissions for raising of debentures are not

deductible (*Texas Land & Mortgage Co.* v. *Holtham,* (1894) 3 *T. C.* 255).

When the employees of the firm are paid commission, it is a question of fact as to whether the commission is on commercial basis, which of course the Taxing Officer can decide and it is open to these Taxing Officers in cases where the excess commission is paid with a view to avoid payment of income-tax to disallow the said excess (*Statt and Ingham* v. *Prehearme,* 9 *T. C.* 69). Money lent to a servant and lost is not a trade loss and is not allowable, but gifts given as perquisites are deductible (*Chittarmal Ramdayal* v. *Commissioner of Income-tax, Punjab,* (1928) 3 *I. T. C.* 54). Here in the course of judgment the Court laid down that the loans made to the employees could not be treated as bad debts of the business either in fact or in land. "Bad debt" is a commercial term for trade debts and cannot include loans made to your own servants, which are entirely private matters, independent of the business. We thank however that it would be a legitimate view that these payments to servants were made a trade expense under Sec. 10, if the Commissioners really thought that they were in the nature of increments to salaries, such as perquisites, or food which a man will supply to his servants in lieu of cash, but to make such perquisites or payments part of expenses of the trade, they must be found by the Commissioner to have been made without any intention to reclaim them and must be claimed as an expense in the year in which they were made. If a servant is paid the expenses of going to his house from business not as a charitable payment, but as an addition to his remuneration, the said payment would be a deductible expenditure from profits (*Babu Jagannath Therani* v. *Commissioner of Income-tax, Bihar & Orissa,* (1925) 2 *I. T. C.* 4). In this case expenditure was incurred by the assessee with respect to both boarding and conveyance in order to retain the services of the employees in the interest of the business and to increase their

efficiency and on that basis it was declared to be an allowable expenditure.

If the employees are paid by allowing them a share of the profits in lieu of remuneration for their services, with or without salary, with a view to create an incentive among them to work more efficiently and harder in order to get more profits, the said expenditure would be allowable as a deduction from the profits (*Johnson Bros. & Co.* v. *Commissioners of Inland Revenue*, 12 *T. C.* 147). On the other hand if the directors are to be paid a certain percentage of profits by way of bonus, after the shareholders are paid a specific dividend, the same would be distribution of profits and not an expenditure incurred with a view to earn profit (*Pegg & Ellam Jones, Ltd.* v. *Commissioners of Inland Revenue*, 12 *T. C.* 82).

It should be noted that Sec. 10 (2) (viiia) of our Indian Income-tax Act, which is an amendment made in the year 1930, specifically lays down that sums paid as bonus or commission to employees can be deducted, provided they are given for services rendered and where they would not have been paid to them as profits or dividends if the allowance was not made on the footing of bonus or commission.

When a bonus is paid to an employee on the termination of his service, as in case of an agent for termination of his agency paid by a company, it was held to be an expenditure.

Life Insurance Companies

It will be seen from the above rules that in case of life assurance companies incorporated in British India, the income, profits and gains, are determined by taking the annual average of the total profits disclosed by the last actuarial valuation, deducting therefrom deductions, if any, made from the gross income in arriving at the said actuarial valuation which are not admissible under the Income-tax Act and adding also any Indian income-tax which the actuary may have deducted from the income

derived from investments before such income was received by the company. The life assurance companies naturally keep their accounts in their own peculiar fashion and to them the ordinary mercantile account keep as applicable to other trading, companies and firms would not in a large measure apply. The premiums received by these life companies are not their income for the simple reason that policyholders must be paid back the bulk of these premiums at the happening of what is called the "critical event." In case of ordinary whole life and endowment assurances, that is with the exception of purely endowment assurances, the fully policy amount has to be provided for from the premiums paid. In case of pure endowments also, which means that if the assured dies before the date fixed for payment of the amount of the policy, he cannot claim anything as far as his insurance policy amount goes, frequently arrangements are made by companies to return the whole of premiums paid upto the date of death, without or with a small interest. It will thus be seen that there is no basis of calculation of income here on the footing of premiums alone, but a very minute and elaborate mathematical calculation has to be made by a specially qualified officer called the "Actuary" who considers the premium income along with what is known as expense ratio, as well as the mortality ratio and other details and arrives at a figure of profit which he declares to have been made during a given period, generally once every three or five years. There are some companies who get these actuarial valuations and calculations made at shorter intervals.

In connection with the Indian income-tax deducted on interest on securities held by the life companies at the source, if such deduction is in excess of the rate at which the tax is to be levied, the same would naturally be refunded. The same rule will also apply under Rule 26 to the determination of the income, profits and gains derived from the annuity and capital redemption business of life assurance companies, the profits of which can be

ascertained from the returns of actuarial valuation. In this connection Para 141 (iii) of the Income-Tax Manual lays down with regard to the refund of tax deducted from the interest on investments of the companies as follows :—

"(*iii*). For the purpose of refund in such cases it is the annual average of the tax deducted from the interest on the company's investments at the source that is to be taken and not, as has been sometimes claimed by insurance companies, the tax actually paid during a particular year of assessment. The reason for this is obvious. The method of assessment based on the previous valuation is itself a concession which, if the companies wish to enjoy, they must take as a whole. If there are to be a subsequent readjustment with reference to any of the transactions in the current actuarial period, this would have to be made after the period was closed with reference to the transactions of the company as a whole during that period, but this course would obviously not be suitable as it would mean very long deferred adjustments."

The other point to be noted here in connection with life assurance is that Rule 30 cited above makes a special concession with regard to the amount written off in accounts or through actuarial valuation of the balance sheet to meet depreciation of or loss on securities or other assets, or which amount is carried to a Reserve Fund formed for the sole purpose of writing off such depreciation, to be treated as expenditure incurred for the purpose of earning the profits of the life business. The reason why exceptional concession is made in case of Investment Reserve Fund in case of life insurance companies, is explained in Para 141 (v) of the Income Tax Manual as follows :—

"The only other fund established by insurance companies for which special provision is made in the rules (Rule 30) is the Investment Reserve Fund. Amounts actually credited by an insurance company of any kind in the ordinary accounts of its business for the accounting period to its Investment Reserve Fund for the purpose of meeting depreciation in the value of its securities can be treated as expenditure incurred for the purpose of earning the profits of the business in determining the taxable income of the insurance company in that year. The reasons for this departure from the general rule that reserves are not allowed

as a business expense are as follows—In the first place it may be noted that these adjustments are not optional, the company is required to make them in order to ensure that its assets are not over-stated in the valuation. The transfer of sums by a Life Assurance Company to Investment Reserve Fund differs, moreover, essentially from the placing of amounts to reserve by a bank or ordinary commercial company, either for the purpose of extending its business, or for the provision of additional working capital; the sums thus placed to reserve are practically speaking composed of undistributed profits. There is also a substantial difference between this transaction on the part of an insurance company, and that by which a bank writes off the depreciation of the securities which it holds. A bank meets depreciation by reducing its Reserve Fund; a Life Insurance Company meets it by reducing its Life Assurance Funds, and this reduction may be made either by writing down its assets or by leaving the assets unaltered, and setting up as a liability an Investment Reserve Fund equal to the depreciation. The latter course is usually adopted; but in both cases the depreciation is a loss, and to tax the amount of depreciation would lead to the anomalous result that the greater the loss to the company the greater would be the amount which it is required to place to its Investment Reserve Fund, and consequently the greater the tax it would have to pay."

On the same footing depreciation is permissible as a deduction.

The Rule 30 also provides that any sum credited for in the accounts or actuarial valuation balance sheet on account of appreciation of or gains on the securities or other assets, shall be deemed to be income chargeable to tax subject always to deduction of such portion thereof as has been otherwise taken into account in calculating the income, profits or gains. In the Rules 27, 29 and 30, the word " may " is used instead of " shall " which means that though as a matter of general practice this concession will be allowed, a discretion is vested in the Taxing Officers to refuse such concessions where they have been in their opinion abused (Para. 141 (vii) I. T. Manual).

The principle on which the profits of life assurance companies can be computed as discussed above has received judicial recognition in the case of *Scottish Union and National Insurance Co.* v. *Smiles*, 2 *T. C.* 551; (1889)

16, *R*. 461; 26 *S. L. R*. 330. Here the Lord President in the course of his judgment, pointed out that the life policies were of most variable endurance and in most cases the premiums were not annual payments, because in some cases the policies may endure for the life-time of the assured and in others for a limited number of years stated, or until the assured attains a certain age. In all these cases the company was bound to pay the amount fixed by the policy when the critical event occurred, or the date or age fixed was reached. He therefore points out that

> "the premiums, therefore, do in no sense represent the annual profits and gains of the company. In like manner the amount of claims in one year arising on the death of persons insured, or as a deduction from the company's receipts for the year, cannot afford any criterion for the ascertainment of profits. A recently established company will receive a large amount of premiums and have few or no claims to meet. The profits and gains can be ascertained only by actuarial calculations, and this actuarial calculation may be obtained by taking the result of the quinquennial investigation prescribed by Statute or the periodical investigation in use in companies established before the Statute, or by an investigation covering the three years prescribed by Schedule D of the Income Tax Acts."

The above case was approved by *Lord Shaw* in *Liverpool and London and Globe Assurance Co.* v. *Bennett*, *(1913) A. C. 610 at p. 617.* (*See also Last* v. *London Assurance Corporation*, (1884) 12 *Q. B. D.* 389 *at p.* 401). In case of mutual insurance business its profits are reduced by the amount of the surplus which is returnable to those participating policyholders who are the members of the mutual assurance company or society and thus the owners of that business (*New York Life Assurance Co.* v. *Styles*, (1889) 14 *A. C.* 381).

It has been also held that there cannot be any assessment of a life insurance company until the first valuation has been made (*Lakshmi Insurance Co. Ltd., Lahore* v. *Commissioner of Income-tax, Punjab,* (1930) 5 *I. T. C.* 24). The grounds on which this was decided

are set out in the judgment of *Jailal J.*, on pages 26 and 27 which is as follows :—

"Now Section 34 of the Indian Income Tax Act reads as follows :— 'If for any reason, income, profits or gains chargeable to income-tax has escaped assessment in any year.............the Income Tax Officer may, at any time within one year of the end of that year, serve on the person liable to income-tax...........a notice.................and may proceed to assess or reassess such income, etc.' The section, therefore, presupposes that the income, profits or gains which can be assessed under it should have been chargeable during the preceding year and also must have escaped assessment.

There is no question raised before us that the income, profits, or gains in question, if assessable were chargeable. But it is contended that they did not 'escape assessment' because this expression implies that they should have been assessable which, it is further contended, means that they were capable of assessment during the previous year. Now it seems that there is a clear distinction between chargeability and assessability. The former expression connotes liability to pay income-tax; the latter expression has reference primarily to the machinery, which ought to be utilised, and the procedure that must be followed in determining the amount which should be levied as income-tax. It, therefore, appears to me that during the year 1927-28 no machinery existed which made it possible in law for the Income Tax Authorities to assess the income, profits or gains of the company during that year.

Section 59 of the Indian Income Tax Act provides that the Central Board of Revenue may........make rules for carrying out *the purposes of the Act and for the ascertainment and determination* of any class of income; it further particularly provides that it may make rules prescribing the manner in which and the procedure by which the income, profits and gains of the insurance companies shall be arrived at. In pursuance of the powers conferred upon the Central Board of Revenue rules have been framed by it and the relevant rule is Rule 25 which is to be found at page 67 of the Income Tax Manual (Second edition). That rule lays down that in the case of Life Assurance Companies whose profits are periodically ascertained by actuarial valuation, the income, profits and gains of the life assurance business shall be the average annual net profits disclosed by the last preceding valuation. Now there is no question that in the year 1927-28 no profits of the *Lakshmi Assurance Company* had been ascertained by actuarial valuation and consequently no assessment was possible during that year under the Indian Income Tax Act, according to the rule

cited above. In other words during that year there were no means provided by law for ascertaining or assessing the income of the company. But the learned counsel who represented the Income Tax Commissioner before us contended that if the actual valuation was not available to the Income Tax Officer during the year 1927-28, it was open to that officer to proceed in the ordinary way, that is to say, to levy the income-tax after obtaining a return of its income from the company as is done in the case of ordinary individuals, companies or associations, and in this connection he contended that the provisions of Section 59 of the Indian Income Tax Act are enabling provisions and that it is not incumbent on the Central Board of Revenue to frame rules under that section. This is true but the Central Board of Revenue have made the rules under that section and the rule concerned is of a mandatory character. It provides the only manner in which the income, profits and gains of Life Assurance Companies can be determined. It does not give any discretion to the assessing officer to depart from its provisions and to have recourse to the other provisions of the Income Tax Act for the purpose of determining and assessing the income, profits and gains of a Life Assurance Company.

That being so. it is clear, in my opinion, that in the year 1927-28 it was not possible under the provisions of the existing law for the Income Tax Officer to assess the *Lakshmi Insurance Company* to income-tax. Can it, therefore, be urged that the income, profits and gains of the company 'escaped assessment' during that year as that term is used in Section 34 of the Indian Income Tax Act. A thing cannot be said to escape certain consequences unless it is capable of facing or being subjected to those consequences and, as, in my opinion, the income of the company was not capable of assessment under the rules laid down by the Central Board of Revenue, which have the force of law, during the year 1927-28 in the absence of an actuarial valuation which valuation according to the wording of Rule 25 referred to above is to be utilized for assessing the income of the succeeding years till the next valuation is made, it cannot be said to have escaped assessment."

Fire, Marine and Accident Companies

In this connection Rule 28 of the Board of Inland Revenue lays down that in case of Fire, Marine, Motor-car, Burglary, etc., insurance companies, which are incorporated in British India, their income, profits or gains, shall be determined in accordance with the ordinary provisions of

the act subject to allowances as provided in Rule 29. This Rule 29 lays down that in case of such companies that is the companies coming under the above denomination and not under that of life assurance, annuity or capital reduction business companies, the amount which they may have actually charged against their receipts for the sole purpose of forming a reserve to meet the outstanding liabilities or in case of risks in respect of policies which have been issued (including risk of exceptional losses) and if not used for any other purpose, such amounts may be treated as expenditure incurred solely for the purpose of earning the profits of the business. This is because in these classes of business, the calculation of profits is practicable and does not become vague as is the case with life assurance companies. In the instructions given to the Taxing Officers in Para. 141 (iv) of the Income Tax Manual, the reasons why the concessions and reductions allowed by the Rule 29 are equitable and just are discussed at some length which may quote with advantage as follows :—

"The reasons underlying the concession granted in this rule should be carefully noted. The profits derived, for instance, by a Fire Insurance Company from the premia which it receives cannot be finally determined until the policies issued in return for the premia have expired and the risks to the company thereunder have terminated, and, as the periods during which the risks endure will not ordinarily coincide with the period on which the assessment to income-tax is based, it is necessary to frame some estimate of the expenditure which the company will be called upon to incur owing to the fact that the risks covered by its premium income in the years of assessment have not entirely ceased. With proper safeguards to prevent manipulation of the accounts, this estimate can equitably be made by treating sums placed by insurance companies carrying on these classes of business to their reserved for unexpired risks as expenditure incurred solely for the purpose of earning this profits of the business. And where, as not infrequently occurs, the reserve is divided into two parts of which the first is intended to cover normal unexpired risks and is generally reckoned at a fixed percentage of the premiums, and the second is intended to cover exceptional losses from widespread calamities, the rule allows this treatment to additions to both

parts of the reserve. The safeguards against abuse which the rule imposes are as follows :—

(1) All sums on account of unexpired risks, which a company wishes to have treated as expenditure for income-tax or super-tax or super-tax purposes, must actually be credited to a fund in the accounts of the company;

(2) They must also be specifically appropriated to meet liabilities under existing contracts; and

(3) The contracts must be with policyholders.

It should be remembered that all these different types of insurance are more or less taken out for short periods. Most of the fire insurance policies run for a period of one year and are renewed if necessary from year to year. There are rare cases where a longer period is provided for, say from five to seven years. In case of Marine insurance, the risk is covered mostly for a voyage and generally for a year, as under the English Marine Insurance Act, 1906, a policy for marine insurance for more than one year is not binding and valid. The motor and accident insurance policies are mostly taken out for a period not more than one year and are renewed, if necessary. Thus the profits of these branches of insurances can be easily ascertained from year to year, as laid down in *Sun Insurance Office* v. *Clark,* (1912) *A. C.* 443. The object should be in case of all these concerns to try and find out the true gains as far as possible. In his judgment *Lord Loreburn, L. C.,* showed that in case of fire insurance companies, the actual taxation cannot be levied on assessment of income upon the actual facts of business done and the actual pecuniary results of it, particularly where the company takes single premiums to cover risks for a year or for more years, which overlap the period of the accountancy year. Thus an estimate has to be arrived at by some method of averages being used and the law cannot lay down any one way of correctly doing so. Whatever method is followed in His Lordship's opinion should be on the footing of an estimate fair both to the Crown and to the subject. His Lordship then mentioned the three

usual methods in this line of business of estimating gains and discussed them as follows on pages 451-53 :—

"I place first, merely for convenience sake and not for its importance or value, a faint suggestion which was made in the case of *McGowan,* (1908) *A. C.* 207, and which as I understood it was as follows :—It was suggested that each contract of insurance made during a particular year should be considered separately. If it had expired, then the actual result should be taken, whether profit or loss. If it had not expired, then an estimate should be made, having regard to the period unexpired and the degree of risk which might be different (in summer and winter for example) during that period.

I do not imagine that either the Crown or the company would seriously desire such an inquiry. I do not know how many fire insurances are effected by a great company within a twelvemonth, probably scores of thousands or even hundreds of thousands. Such a process, as to the unexpired contracts, would be minute and almost interminable. It was rejected because there was no evidence that it would be a reasonable way of ascertaining what was desired.

The second method suggested in that case was that of merely taking for each year the sum total of the premiums received and the sum total of the losses paid and substracting the one from the other, without regard to the fact that the premiums cover risks running on into subsequent years and the losses include losses arising out of contracts made in previous years. This method is of course not precise or scientific. It proceeds upon the view that when this is done for the three consecutive years indicated by the statute and the figures thus reached are averaged, a fair and reasonable conclusion is attained.

This method was adopted long ago and has more than once been the subject of consideration in Courts of Law. I can conceive it being unfair either in the case of a rapidly increasing or of a rapidly diminising fire insurance business. It may prove unfair in other cases. But in *McGowan's Case* cited above it was not proved to be unfair. On the contrary it closely corresponded with the dividends actually distributed and was upon the facts of that case clearly the most accurate and reasonable of the methods which alone were propounded for our consideration. Accordingly it was adopted.

I think it is in general a good working rule, but no one in this House has said that it ought to supersede the truth if the truth is in conflict with it in any case.

A third method, similar in principle to that advanced by the new appellants, was also considered by your Lordships in the

case of *McGowan* cited above. This method is to carry forward annually at the close of the year a percentage of the premium income in order to allow for unexpired risks. It has no pretensions to being precise. I easily imagine cases in which an actuary could show it was misleading. But if it comes nearer to the truth than any other method in a particular case, I do not understand why it should not be adopted.

This third method, however, in its applications to that case, the *McGowan's Case,* would have meant that the insurance company was to pay income tax upon the footing of about £15,000 or £20,000 profits and gains in the three statutory years, whereas they had divided dividends of about £60,000 in those three years. And there was no evidence and no finding, nor could there honestly have been, that the third method worked fairly between the Crown and the subject.

In those circumstances this House rejected the third method. The House adopted the second, but, so far from laying it down as a rule of law, it was expressly pointed out that the second method was of itself imperfect, though a good working rule generally, would not be applicable if in any case it appeared upon the facts to involve hardships."

It is also held that it was a necessary party of the fire insurance company's business to hold investments in stocks, shares and securities and to occasionally sell them at a profit or loss. Thus in case of loss, a deduction is allowable and in case of profit an addition to the income must be made (*Royal Insurance Co.* v. *Stephen,* (1928) 44 *T. L. R.* 630).

Foreign Income and Foreign Companies

In connection with this Sec. 4 (2) with explanation of the Income Tax Act is important. It runs as follows :—

(2) Profits and gains of a business accruing or arising without British India to a person resident in British India shall, if they are received in or brought into British India, be deemed to have accrued or arisen in British India and to be profits and gains of the year in which they are so received or brought notwithstanding the fact that they did not so accrue or arise in that year, provided that they are so received or brought in within three years of the end of the year in which they accrued or arose.

Explanation :—Profits or gains accruing or arising without

British India shall not be deemed to be received or brought into British India, within the meaning of this sub-section by reason only of the fact that they are taken into account in the balance-sheet prepared in British India.

The above sub-sec. 2 was inserted in the Act as formerly taxes used to be evaded in case of income accruing or arising out of British India and received in British India by bringing the said income at intervals and contending that as the said income was not received in the year in which it arose or accrued out of British India it was not assessable in the year of assessment. Now these profits or incomes, whenever brought within a period of three years of the Act of the year in which they accrued or arose, will be treated as incomes of the year in which they are so received and assessed. This of course applies to profits or gains and not to importation of capital which must be carefully distinguished. The extreme limit to which a person could be so assessed for profits of business abroad paid into British India is that of last three years. A person may have more than one residence if he maintains an establishment at each of them. Thus in *Inland Revenue* v. *Cadwalader,* (1904) 5 *Tax cases* 101 a foreigner who spent two months every year in the United Kingdom was held to reside there. He need not have a regular house and even a tramp may be a resident in the country or one who lives in hotels or stays with friends or relations (*Lysaght* v. *Commissioner of Inland Revenue*, (1928) *A. C.* 234; 13 *Tax cases* 511). In case of companies, its place of business or business office has to be considered as equivalent to its residence (*De Beers* v. *Howe,* (1906) *A. C.* 455). In one of the cases, a company registered in the United States of America had a registered office in Belfast, also where meetings were held and minute book was kept and accounts audited, it was held that the company was resident in Ireland (*John Hood & Co.* v. *Magee,* (1918) *I. R.* 34; 7 *Tax cases* 327).

A company can also have more than one residence (*Swedish Central Ry. Co.* v. *Thompson,* (1925) *A. C.*

495; *T. S. Firm* v. *Commissioner of Income-tax*, (1927) 50 *Mad.* 847). In the latter case it was decided that the residence of a firm does not depend on the residence of partners, but on the place of control, and thus a firm can have more than one residence simultaneously. Where a foreign income is received within British India after it has paid the income-tax in foreign country, it will be calculated as the gross income and not deducting the foreign tax [S. 10 (2) Proviso to sub-section (ix)]. This proviso lays down that nothing shall be deemed to authorise the allowance of any sum paid on account of any cess, rate or tax levied on profits or gains on any business, or assessed at a proportion of or otherwise on the basis of any such profits or gains. This is of course subject to Sec. 49 of the Income Tax Act, which runs as follows :—

Sec. 49 (*1*). If any person, who has paid Indian income-tax for any year on any part of his income, proves to the satisfaction of the Income Tax Officer that he has paid United Kingdom income-tax for that year in respect of the same part of his income, and that the rate at which he was entitled to, and has obtained, relief under the provisions of Sec. 27 of the Finance Act, 1920, is less than the Indian rate of tax charged in respect of that part of his income, he shall be entitled to a refund of a sum calculated on that part of his income at a rate equal to the difference between the Indian rate of tax and the rate at which he was entitled to, and obtained, relief under that section.

Provided that the rate at which the refund is to be given shall not exceed one-half of the Indian rate of tax.

It will be seen from the above that this relief from double income tax is given in connection with income taxed in British India and the United Kingdom. A company which was incorporated in the United States of America with the head office in New York and branches, agencies and factories in Calcutta and which purchased goods in India for sale in America, etc., was held not to be exempted from assessment from income tax or super-tax in India (*Re. Rogers Pyatt Shellac & Co.* v.

Secretary of State for India, (1925) 52 *Cal.* 1; 1 *I. T C.* 363).

In the famous case *Commissioner of Income-tax, Bombay* v. *Remington Typewriter Case*, (1928) 30 *Bom. L. R.* 1190, the Remington Company of New York started three companies in India at Bombay, Madras and Calcutta, to take over the business of sale of their typewriting machines and accessories. All the shares of these companies were held by an American Company except two or three. The Indian companies purchased typewriters from the American company at a certain discount from the catalogue prices and sold them in India. The profits made in India by these companies after deduction of income-tax were sent to America as dividends. It was claimed on behalf of the Income Tax authorities that besides profits made by way of dividend, the manufacturer's profit which was made by the American company in respect of goods sold by it through the Bombay company was the agent of the American company as it had a Tax Act 1922 and that the Bombay company was the agent through whom the tax should be recovered. It was held by the Appeal Court in India that the Bombay company was the agent of the American company as it had a business connection with the said company within the meaning of Sec. 43 of the Income Tax Act, but this agent, *viz.*, The Bombay company was not in receipt, on behalf of the American company, of the manufacturer's profit and thus could not be assessed to income tax or super-tax on such profits under Sec. 42 (1) of the Act. The matter went to the Privy Council (*Commissioner of Income-tax* v. *Remington Typewriter Co. Ltd.*, (1931) 33 *Bom. L. R.* 413), where after reviewing carefully relevant sections, the Privy Council held that the view expressed by the Appellate Court of Bombay as to the meaning of the word agent as used in Sec. 41 (1) and in Sec. 40 being one and the same was erroneous. In the opinion of their Lordships any person who comes within the term of Sec. 43 of the Indian Income Tax Act 1922 is put by that sec-

tion artificially in the position of the agent and the assessee under Sec. 42 (1). The word agent in the latter sub-section not being confined as in Sec. 40 to a person who actually receives the profits and gains. In this case, in their Lordships' opinion, it was established that the profits or gains accrued or arose to a non-resident person directly or indirectly through or from any business connection in British India and the agent had business connection with such non-resident person, therefore the agent was liable to assessment to income tax and super-tax under the provisions of Sec. 42 (1) in respect of the profits made by the non-resident although such agent was not himself in receipt of the profits.

In another case the assessee, known as Bombay Trust Corporation Ltd., was a financing company, having huge monetary dealings with another financing company called H. T. Corporation which was incorporated in Hongkong. The Hongkong Corporation lent deposits without security to the B. T. Corporation for large amounts at a fixed rate of interest. The said interest earned by the Hongkong Corporation was forwarded by the Bombay Corporation to Hongkong through a local firm having an office in Bombay and Shanghai. The Income Tax authorities assessed the Bombay Corporation as agents of the Hongkong Corporation to income-tax and super-tax with respect to interest remitted to Hongkong, it was held that the Hongkong Corporation was carrying on an assessable business within British India with an income accruing or arising in British India within the meaning of Sec. 4 of the Indian Income-tax Act, 1922, and that the relation between the two companies was that of borrower and lender and that though the Bombay Corporation may be deemed to be an agent of the Hongkong Corporation for the purposes of Secs. 40 and 42, they could not be assessed as it was not in receipt of any income on behalf of the Hongkong Corporation (*Commissioner of Income-tax* v. *Bombay Trust Corporation Ltd.,* (1928) 30 *Bom. L. R.* 1172).

The burden of proof that the profits accrued or arose more than three years back is on the assessee (*The Commissioner of Income-tax, Madras* v. *S. K. R. S. L. Firm*, (1927) 50 *Mad.* 853). Where the assessee was appointed a selling agent of a mill company at Indore (an Indian State) and under an agreement with the company at Indore the assessee was entitled to a commission on gross sale proceeds of the mill at Indore, the assessee opened a shop in the British India where he sold the produce of the mill but the commission on sale was received by them at Indore. Here it was held that the income in question, having been commissioned upon sales in British India, accrued and arose in British India and nonetheless so because, as a matter of practice between the parties, it was paid in Indore and the ultimate right to it arose under an agreement in Indore (*Commissioner of Income Tax, Bombay* v. *Swarupchand Hukumchand,* (1931) 33 *Bom. L. R.* 382). Where a company incorporated in England constructed a railway in the French Colony of Pondicherry in India and obtained from the French Government in concession to construct and work the line, agreeing to make over to the Colonial French Government half of the net profits and the railway was managed by South Indian Railway in British India as if it were an integral part of their undertaking, the question arose whether the income remitted to London by the company in India after paying the share due to the French Government was assessable under the Indian Income Tax Act. It was held that the said income derived by the assessee company from payments to it by South Indian Railway received in British India by the agent of the assessee company there on their behalf and thus the assessee company was liable to be assessed to income-tax under Sec. 4 (1) of the Indian Income Tax Act, 1922, and that the payments constituted profits or gains of a business carried on by the assessee company. It was further held that an yearly payment made to the French Colonial Government was a distribution of profits and not an allowance deductible from

those profits (*Pondicherry Ry. Co., Ltd.* v. *Commissioner of Income-tax,* (1931) 33 *Bom. L. R.* 1263). In another case where it was sought to assess the company with income tax as the agent of shareholders because it paid dividends to them, it was held by the majority of judges that the company was not an agent within the terms of Secs. 31 and 34 of the Act (*Imperial Tobacco Co. of India Ltd.* v. *The Secretary of State for India,* (1922) 48 *Cal.* 721).

Liability of Agent of Non-Resident Foreigners

We have seen in the above discussion in connection with foreign income and foreign companies that in case of foreigners or non-residents carrying on business within British India through an agent the tax is recovered through the assessment of agent. This is done under Sec. 40 of the Income Tax Act of 1922, which runs as follows :—

> In the case of any guardian, turstee or agent of any person being a minor, lunatic, or idiot or residing out of British India (all of which persons are hereinafter in this section included in the term "beneficiary") being in receipt on behalf of such beneficiary of any income, profits or gains chargeable under this Act, the tax shall be levied upon and recoverable from such guardian, trustee or agent, as the case may be, in like manner and to the same amount as it would be leviable upon and recoverable from any such beneficiary if of full age, sound mind, or resident in British India, and in direct receipt of such income, profits or gains, and all the provisions of this Act shall apply accordingly.

This liability of agent of a non-resident is a personal liability (*Plunkett* v. *Narain Parasuram,* (1898) 22 *Bom.* 332; 1 *I. T. C.* 1). Of course a notice has to be given to the agent who is sought to be assessed as provided for by Sec. 43 of the Income Tax Act, which runs as follows :—

> "Any person employed by or on behalf of a person residing out of British India, or having any business connection with such person, or through whom such person is in the receipt of any income, profits or gains upon whom the Income Tax Officer has caused a notice to be served of his intention of treating him as

the agent of the non-resident person, shall, for all the purposes of this Act, be deemed to be such agent;

Provided that no person shall be deemed to be the agent of a non-resident person, unless he has had an opportunity of being heard by the Income Tax Officer as to his liability.

These notices may be served on more than one agent if the non-resident has more agents than one within his jurisdiction finally selecting any one of them and assessing him on the combined income of his principal through all the agents within the jurisdiction of British India. The object of serving this notice is to give an opportunity to the agent to state his case and show cause, if he can, as to why he should not be treated as an agent of the foreigner or non-resident and made liable as such. The notice of course has to be served once, *i.e.*, at the beginning when it is sought to charge him as an agent and for future assessment no further notices need be given.

The Act does not give any definition by which, in any particular instance, it could be decided as to whether a non-resident is or is not carrying on business in British India and does not expressly state how the amount of taxable property is to be arrived at. However Rules 33-35 prescribe the manner in which, and the procedure by which the income, profits and gains may be arrived at in the case of non-residents. The rules run as follows :—

Rule 33. In any case in which the Income Tax Officer is of opinion that the actual amount of the income, profits or gains accruing or arising to any person residing out of British India, whether directly or indirectly through or from any business connection in British India, cannot be ascertained, the amount of such income, profits or gains, for the purposes of assessment to income-tax, may be calculated on such percentage of the turnover so accruing or arising, as the Income Tax Officer may consider to be reasonable, or on an amount which bears the same proportion to the total profits of the business of such person (such profits being computed in accordance with the provisions of the Indian Income Tax Act) as the receipts so accruing or arising bear to the total receipts of the business, or in such other manner as the Income Tax Officer may deem suitable.

Rule 34. The profits derived from any business carried on

in the manner referred to in Sec. 42 (2) of the Act may be determined for the purposes of assessment to income-tax according to the preceding rule.

Rule 35. The total income of the Indian branches of non-resident insurance companies (Life, Marine, Fire, Accident, Burglary, Fidelity Guarantee, etc.), in the absence of more reliable data, may be deemed to be the proportion of the total income, profits or gains, of the companies, corresponding to the proportion which their Indian premium income bears to their total premium income.

On the same footing the Indian branches of non-resident firms are liable to assessment under the Act. In order to secure an accurate assessment in such cases Secs. 22 (4) and 37 empower the Income-tax Officer to require the production of the balance-sheet and the profit and loss account of the firm as a whole, in addition to that of the Indian branch and also to require the submission of a detailed statement of all profits credited to the personal account of the head office on account of transactions carried out on its behalf. Where the accounts of the foreign head office and the Indian branch do not enable the share of profits due to the Indian branch to be accurately gauged, Rule 33 as quoted above gives the Income Tax Authorities wide powers to determine how the profits of the Indian branch shall, under these circumstances, be calculated. Even the percentage of turnover of business done by the branch or an amount which bears the same proportion to the total profits of the business as Indian receipts bear to the total receipts of business or any other reliable method of calculation may be followed. In case of shipping companies the most suitable method of assessing, according to the Income Tax Manual, is to calculate tax on the same proportion of total profits of the company as the Indian receipts of the company bear to the total receipts. Indian receipts here mean sums received either in India or elsewhere, on account of goods shipped or passengers carried from India. In case of insurance companies, life, fire, marine, accident, etc., the method which is said to be most equitable by the Income

Tax Manual is the assessment to these branches on the proportion of the total profits of the companies corresponding to the proportion which their Indian premium income bears to their total premium income.

In case of agents of non-resident firms or companies of which they are neither branches or subsidiary firms, it is not necessary that the regular agency should exist in order to make the profits of non-resident chargeable in the name of an agent because according to Income Tax Manual they are chargeable even when the only connection between the non-resident and the person acting as an agent is that that person is ordinarily and regularly employed as an agent by the non-resident. Thus the question of agency will be a question of fact to be determined on the circumstances bearing on each case. To take an example, if there is no privity of contract between the foreign principal and a resident who purchases the foreign principal's products through another resident or if the resident has to bear any bad debts arising out of such transaction, the resident vendor is not to be treated as the agent of the non-resident. But if a non-resident does not bear bad debts he will be considered to be trading in the country if there is a privity of contract.

In case of casual agents for non-resident firms to whom goods are sent from time to time or consigned, taxation through the agent of a non-resident is not exempted by the authorities.

INCOME FROM PROPERTY

In this connection on the income of property held by a Joint Stock Company the tax is payable in respect of the *bona fide* annual value of the property which is deemed to be made up of buildings or lands, appurtenants thereto and of which the company is the owner, other than the property or such portion of it which is occupied by the assessee for the purposes of its business. The *bona fide* annual value is the full market value at which the property could be let from time to time without calculat-

ing any charges by way of municipal debts or taxes that may be made thereto. Sec. 9 of the Income Tax Act deals with this power, which runs as follows :—

Sec. 9(1). The tax shall be payable by an assessee, under the head " Property," in respect of the *bona fide* annual value of property consisting of any buildings or lands, appurtenant thereto of which he is the owner, other than such portions of such property as he may occupy for the purposes of his business, subject to the following allowances, namely :—

(*i*) Where the property is in the occupation of the owner, or where it is let to a tenant and the owner has undertaken to bear the cost of repairs, a sum equal to one-sixth of such value;

(*ii*) where the property is in the occupation of a tenant who has undertaken to bear the cost of repairs, the difference between such value and the rent paid by the tenant up to but not exceeding one-sixth of such value;

(*iii*) the amount of any annual premium paid to insure the property against risk of damage or destruction;

(*iv*) where the property is subject to a mortgage or charge or to a ground rent the amount of any interest on such mortgage or charge or of any such ground rent;

(*v*) any sums paid on account of land-revenue in respect of the property;

(*vi*) in respect of collection charges, a sum not exceeding the prescribed maximum;

(*vii*) in respect of vacancies, such sum as the Income Tax Officer may determine having regard to the circumstances of the case.

Provided that the aggregate of the allowances made under this sub-section shall in no case exceed the annual value.

(2) For the purposes of this section, the expression "annual value" shall be deemed to mean the sum for which the property might reasonably be expected to let from year to year.

Provided, that, where the property is in the occupation of the owner for the purposes of his own residence, such sum shall, for the purposes of this section, be deemed not to exceed ten per cent. of the total income of the owner.

If a person or a company derives an income from a property which is held on lease, the tax is levied under Sec. 12 of the Income Tax Act, which lays down that

tax shall be payable by an assessee under the head " other sources " in respect of income, profits and gains of every kind and from every source to which this Act applies, if not included under any of the preceding heads. Of course the usual deductions for expenditure will be allowed from the income in this case also. We have seen that the annual value is calculated on the basis of the market value of the property at which it could be let from year to year and the municipal valuation here is not taken into account. The result is that the actual rent payable on a long term lease or the actual rent payable on yearly lease under a privilege rental, differs from the market value of the rents. Where the owner himself occupies the building, the annual value is restricted to a maximum of 10 per cent. of the total income of the owner himself, which is a limitation of concession in this case.

The deductions allowed in connection with property are :—

(1) Repairs expenses not exceeding one-sixth of the annual value and this allowance is a fixed allowance irrespective of the fact whether the money was actually spent or not.

(2) Whether the property is let and the tenant pays the cost of repairs, the repairs to the extent not exceeding one-sixth of the value will be allowed.

(3) Whether the property is mortgaged or charged or subject to ground rent, the amount of interest on such mortgage or charge or ground rent is allowed.

(4) Premiums paid for insurance of the property against risk of destruction or damage.

(5) Any amount paid on account of land revenue in respect of the property.

(6) Collection expenses to the extent of a sum not exceeding the prescribed maximum of 6 per cent. of the annual value of the property. This includes net legal expenses in connection with collection after deducting costs recovered, if not from the opposite party.

(7) In case of foreigners, such sum as the Income Tax Authorities may determine having regard to the circumstances of the case. The allowance is not to exceed in any case the annual value.

(8) In case of unrealised rents, if legal steps are taken to realise same, the same will not be computed until realised.

RECOGNISED PROVIDENT FUND

All large corporations and Joint Stock Companies generally encourage their employees to look up to their company for a permanent connection and thus provide for them a fund available to them either on retirement or on surrender through the creation of what is commonly known as the "Provident Fund." The Income Tax Act also encourages creation of such funds by providing for them certain concessions and exemptions which we shall now consider under this heading. The first concession is to be found under Sec. 4 (3) (iv) under which interest on securities which are held by or are the properties of any Provident Fund to which the Act 29 of 1925 applies. On the same footing Sec. 4 (3) (v) provides for exemption from taxation of all capital sums paid as accumulated balances at the credit to subscribers to such fund in computing their total income. The words accumulated balance includes not only contribution but also interest thereon. Contributions paid by a subscriber under Sec. 15 (1) (ii) are also exempt. The sub-sec. 1 applies to sums paid by the assessee in case of insurance of his own life or on the life of his wife or in respect of a contract for a deferred annuity on his life or on the life of his wife or as a contribution to a Provident Fund to which the Act applies and sub-sec. 2 applies to the assessee who is a Hindu undivided family for sums paid to effect an insurance on the life of any male member of the family or of the wife of any such member. Such exemptions are not taxed in the aggregate of any sums exempted under this section or proviso of sub-sec. 1 of Sec. 7 or sub-sec. 1 of Sec. 58 (5) one-sixth of the total income of the assessee.

The new Amending Act of 1929 has introduced a new Chapter IXA under which it has created certain

Provident Funds which are known as "Recognised Provident Funds." The recognised Provident Fund means a provident fund which has been and continues to be recognised by the Commissioner in accordance with the provisions of Chapter IXA. In order to be recognised for exemptions the Provident Fund has to satisfy, in the opinion of the Commissioner of Income Tax, the conditions prescribed in Sec. 58C and the rules made thereunder, which recognition may be withdrawn if any of the conditions are contravened. The Governor-General in Council can also at his discretion direct Commissioner of Income Tax to refuse to accord recognition to any Provident Fund or may at any time withdraw the recognition from any recognised Provident Fund. The conditions to be fulfilled as laid down by Sec. 58C are as follows :—

(1) In order that a provident fund may receive and retain recognition, it shall satisfy the conditions set out below and any other conditions which the Governor-General in Council may, by rule, prescribe :—

(*a*) All employees shall be employed in India, or shall be employed by an employer whose principle place of business is in British India.

(*b*) The contributions of an employee in any year shall be a definite proportion of his salary for that year, and shall be deducted by the employer from the employee's salary in that proportion, at each periodical payment of such salary in that year, and credited to the employee's individual account in the fund.

(*c*) Subject to the provisions of Sec. 58D, the contributions of an employer to the individual account of an employee in any year shall not exceed the amount of the contributions of the employee in that year, and shall be credited to the employee's individual account at intervals not exceeding one year.

(*d*) The fund shall consist of contributions as above specified, of accumulations thereof, and of interest (simple and compound), credited in respect of such contributions and accumulations, and of securities purchased therewith, and of no other sums.

(*e*) The fund shall be vested in two or more trustees or in the official trustee, under a trust which shall not be revocable, save with the consent of all the beneficiaries.

(*f*) The employer shall not be entitled to recover any sum whatsoever from the fund, save in cases where the employee is dismissed for misconduct or voluntarily leaves his employment otherwise than on account of ill-health or other unavoidable cause before the expiration of the term of service specified in this behalf in the regulation of the fund.

In such cases the recoveries made by the employer shall be limited to the contributions made by him to the individual account of the employee, and to interest (simple and compound) credited in respect of such contributions and accumulations thereof, in accordance with the regulations of the fund.

(*g*) The accumulated balance due to an employee shall be payable on the day he ceases to be an employee of the employer maintaining the fund.

(*h*) Save as provided in clause (g), or in accordance with such conditions and restrictions as the Governor-General in Council may, by rules, prescribe, no portion of the balance to the credit of an employee shall be payable to him.

(2) Where there is a repugnance between any regulation of a recognised provident fund and any provision of this chapter or of the rules made thereunder, the regulation shall, to the extent of the repugnance, be of no effect.

The Commissioner may, at any time, require that such repugnance shall be removed from the regulations of the fund.

There is of course power provided for by Sec. 58D under which, subject to any rules which the Governor-General in Council may make, the Commissioner can, in respect of the particular fund, relax the provisions of condition C of sub-sec. 1 of Sec. 58C, (a) so as to permit the payment of a larger contribution by an employer to the individual accounts of employees whose salary does not exceed Rs. 500 per mensem and (b) so as to permit the crediting by the employers whose individual accounts of employee of periodical bonus or other contributions of a contingent nature, where the calculation in payment of such bonus or other contributions is provided for on definite principles by the regulations of the fund, but unless these are provided for in the regulations of the fund and given to the employees irrespective of the employers' volition,

the contributions will not be eligible for the concession. Where the principal place of the business of the company is outside British India, the provident fund of employees of British India business in order to be recognised should be kept separate and must conform to the conditions imposed by the Act and the rules under the Act. The words all employees only include such employees as are subscribing to the fund. Where the principal place of business of the company is in British India, there is no objection to the foreign staff, *i.e.*, staff outside British India subscribing to the Provident Fund. They will not get any release of tax on monthly contributions since their salaries have not been earned outside British India, will not be taxed but they will get the advantage of exemption from the income-tax of the interest on the investment of the above.

With regard to the annual accretion in the year of the balance to the credit of an employee participating in recognised provident fund, the accretion shall be deemed to have been received by him in that year and shall be computed on the total income of that year and liable to income-tax and super-tax.

This is according to Sec. 58 (f) subject to this that the employee shall not be liable to pay income-tax on contributions to his individual account in a recognised provident fund in so far as the aggregate of such contributions in any year does not exceed one-sixth of his salary in that year. Ultimately when the employee gets his provident fund amount after having rendered continuous service with his employer for a period of not less than five years such accumulated balance shall be exempt from payment of income-tax and super-tax and shall be excluded from the computation of his total income (Sec. 58 (g)). Here also the Commissioner of Income-tax may allow an exemption or exclusion where the employee has rendered a service for a period of not less than five years, if in his opinion the service has been terminated by reason of employee's ill-health or by the

contraction or discontinuance of the employer's business or other cause beyond the control of the employee.

The accounts of the recognised provident funds have to be maintained by the trustees of the fund and must be in such form and for such periods and shall contain such particulars as the Central Board of Revenue may prescribe. Such accounts shall be open to inspection at all reasonable times by the Income Tax Officers, and the trustees must furnish to the Income Tax Officer such abstracts of the account as the Central Board of Revenue may prescribe (Sec. 58I).

NEWLY RECOGNISED PROVIDENT FUNDS

In connection with newly recognised provident funds, the provisions of Secs. 58J and 58K of the Income Tax Act are important. They are as follows :—

Sec. 58 J (1) Where recognition is accorded to a provident fund with existing balances, an account shall be made of the fund up to the day before the day on which the recognition takes effect, showing the balance to the credit of each employee on such day, and containing such further particulars as the Central Board of Revenue may prescribe.

(2) The account shall also show, in respect of the balance to the credit of each employee, the amount thereof which is to be transferred to that employee's account in the recognised provident fund, and such amount (hereinafter called his transferred balance) shall be shown as the balance to his credit in the recognised provident fund on the date on which the recognition of the fund takes effect, and sub-secs. (3) and (4) shall apply thereto.

Any portion of the balance to the credit of an employee in the existing fund which is not transferred to the recognised fund shall be excluded from the accounts of the recognised fund and shall be liable to income-tax and super-tax in accordance with the provisions of this Act other than this Chapter.

(3) Subject to such rules as the Central Board of Revenue may make in this behalf, the Income Tax Officer shall make a calculation of the aggregate of all sums comprised in a transferred balance which would have been liable to income-tax if this chapter had been in force from the date of the institution of the fund, without regard to any tax which may have been paid on any such sum, and such aggregate (if any) shall be

deemed to be income received by the employee in the year in which the recognition of the fund takes effect, and shall be included in the employee's total income for that year; and for the purposes of assessment, the remainder of the transferred balance shall be disregarded, but no other exemption or relief, by way of refund or otherwise, shall be granted in respect of any sum comprised in such transferred balance.

Provided that, in cases of serious accounting difficulty the Commissioner shall have power subject to the said rules, to make a summary calculation of such aggregate.

(4) Notwithstanding anything contained in condition (*h*) of sub-sec. (1) of Sec. 58C, an employee, in order to enable him to pay the amount of tax assessed on his total income as determined under sub-sec. (3), shall be entitled to withdraw from the balance to his credit in the recognised provident fund a sum not exceeding the difference between such amount and the amount to which he would have been assessed if the transferred balance had not been included in his total income.

(5) Nothing in this section shall affect the rights of the persons administering an unrecognised provident fund or dealing with it, or with the balance to the credit of any individual employed, before recognition is accorded, in any manner which may be lawful.

Sec. 58K (1) Where an employer, who maintains a provident fund (whether recognised or not) for the benefit of his employees and has not transferred the fund or any portion of it, transfers such fund or portion to trustees in trust for the employees participating in fund, the amount so transferred shall be deemed to be of the nature of capital expenditure.

(2) When an employee participating in such fund is paid the accumulated balance due to him therefrom, any portion of such balance as represents his share in the amount so transferred to the trustee (without addition of interest, and exclusive of the employee's contributions and interest thereon) shall be deemed to be an expenditure by the employer within the meaning of clause (ix) of sub-sec (2) of Sec. 10, incurred in the year in which the accumulated balance due to the employee is paid.

DEDUCTION OF TAX ON SALARIES

The Income-tax is naturally levied on salaries or wages, annuities, pension or gratuities, fees, commission, perquisites or profits received by the employee in lieu of salary is also taxable. Salary may be paid on behalf of the company or any other public body or association, Government or any private employer. In this salary the

free occupation of any place of residence by the employee provided for by the employer is calculated as a perquisite (Sec. 7 I. T. A.). Perquisites whether payable in money as well as in any other value is thus now taxable.

The Income Tax Act in Sec. 18 provides for the deduction by the employer at the time of payment of income-tax from the salaries paid by the company to its employees. The rate at which the tax is to be deducted on the amount payable is to be calculated on the amount payable as salary at the rate applicable to the estimated income of the assessee. These deductions are to be treated as payments of income-tax on behalf of the person for whom the deduction was made and in the assessment, credit will be given to that person, with regard to other income by the income-tax authorities. Failure on the part of the employer to deduct tax from the salary of his employee will make him personally liable for the tax; on deduction the employer should give to the person whose salary was concerned a certificate to the effect that the income-tax had been deducted, specifying the amount so deducted and such other particulars as may be prescribed. Besides being personally liable the employer who fails to deduct salary may be prosecuted for an offence punishable under Sec. 51A of the Income Tax Act with fine which may extend to Rs. 10 for every day during which the default continues.

It will thus be seen that what Sec. 18 of the Act provides is that the tax should be deducted at the source as distinguished from taxation at the source. Here the tax is deducted by person responsible for making payment of salaries before such payments reach the hands of the recipients. Under the present Act it is laid down that deductions from salaries shall be made at a rate which should approximate as closely as possible to the rate appropriate to the table of assessable income of the assessee under the head "Salaries" and it further provides that the person deducting the income-tax salaries has the power to rectify in subsequent deductions mistakes made in

previous deductions. According to Income Tax Manual, as an illustration, if an employee's regular monthly salary happens to be Rs. 500, the tax would be deducted by the employer at the rate appropriate to Rs. 6,000, but if such an employee receives a commission or bonus or arrears of pay or officiating allowance amounting to Rs. 5,000, the employer is empowered to not only make deductions in future at the rate appropriate to an income of Rs. 11,000, to make up the deficiency in previous collections owing to the lower rates having been applied. There are cases where salaries are adjusted annually and meanwhile the employee is allowed to draw and even withdraw against salary due or that will become due to him later. If the employees of such an employer claim to deduct as business expenses, the sums thus drawn, they can only do so on the ground that the sum represents salary and therefore the tax should be deducted according to the Income Tax Manual at source from all such sums. Of course if it is discovered by the Income Tax authorities that the tax has not been so deducted they would assess the employee direct on all such sums if they have been allowed to the employer as business expenses. If they are not so allowed they will not be so taxed in the employee's hands either by deduction or by direct assessment till the drawings are adjusted against salary actually earned and are claimed as business expenditure by the employer.

The form in which the return has to be made with regard to the salaries paid by the employer together with the forms of the employees and the tax deducted, is as under :—

The return to be delivered to the Income Tax Officer under Sec. 21 of the Act shall be in the following form :—

The return to be delivered to the Income Tax Officer under Sec. 21 of the Act shall be in the following form :—

Serial number.	Name of person.	Postal address of residence.	Appointment or nature of employment.	Total amount of salary, wages, annuity or pension paid during the year ending on 31st March, 19 .	House allowance or value of rent-free quarters.	Amount of bonus, gratuity, fees, commission perquisites or allowances (other than those shown in column 6) or profits in lieu of or in addition to salary or wages (each to be shown separately).	Total of columns 5, 6 and 6A. Deduction on account of	Provident and other funds [proviso to Section 7 (1)].	Deduction on account of Life Insurance premia (Section 15).	Net amount chargeable.	Amount of tax payable.	Reduction under Section 17.	Amount of tax deducted.	If the employee person contributes to a recognised provident fund (Chapter IXA) the amount of the employer's contribution thereto.	Remarks.
1	2	3	4	5	6	6A	7	8	8A	9	10	11	12	12A	13

I certify that the above statement contains a complete list of the total amounts paid by......................to all persons who were receiving income on the 31st day of March, 19..........at the rate of Rs. 1,000 per annum, or have received during the year ended on that day not less than Rs. 1,000 in respect of salary, wages, annuity, pension, gratuity, fees, commissions, perquisites or profits in lieu of or in addition to salary or wages, and that all the particulars stated are correct.

Signature of person by whom the return is delivered.

Date............

DEDUCTION OF TAX ON INTEREST OF SECURITIES

The same Sec. 18 which we have discussed in the above paragraph in connection with salaries also provides for the deduction of tax under sub-sec. 3 where it is laid down that a person responsible for paying any income chargeable under the head "Interest on securities" shall at the time of payment deduct income on the amount of the interest payable at the maximum rate. Here the tax will be deducted at the maximum rate because the person paying the interest has no information regarding the total income of the person to whom the payment is made, whereas later can claim refund from the Income Tax Authorities of the excess by proving his income. If a company has issued debenture loans it has to deduct tax from the interest which it pays to the holders of these debentures at the maximum rate. The usual certificate of having so deducted the tax at the source is naturally given. The certificate would be in the following form :—

Name of Local Authority|Company.

Address.

To (1)

Name and address of payee (2)

I|We hereby certify that Rs..............being income-tax at

---

(1) Name and address of the owner of security should be given here. In the case of bearer debentures or bonds, these particulars are to be given as declared by the payee concerned.

(2) To be completed only in the case of bearer debentures or bonds.

the rate of..............pies per rupee has been deducted from Rs................being the amount of interest at the rate of...... per cent. per annum due (3)............on debentures Nos......... of Rs...............each of the (4)............and that it has been or will, within the prescribed period, be paid by me|us to the Government of India at

Superintendent, Public Debt Office,
or Principal Officer or Managing Agents,

........................19......

(To be signed by claimant).

I hereby declare that the securities on which interest as above specified has been received, were my own property and were in the possession of......................at the time when income-tax was deducted.

Signature
Date.

(N. B.—The securities to be produced when required in support of any claim).

Dividends as a Shareholder

Any sum which a person receives by way of dividends as a shareholder in a company where the profits or gains of the company have been assessed to income-tax will be exempt from income-tax in the hands of the assessee though not super-tax. This is because a dividend which is received by the shareholder of a joint stock company is an income which is assessed under Sec. 6 (vi) under the heading of "Income from other Sources." From this dividend as we have already seen while dealng with income-tax payable by joint stock companies, the income-tax at the full standard rate is deducted at a source by the company itself and the shareholder is left to apply for a refund if the scale of taxation applicable to him is lower than the one at which the deduction is made.

Under both the Acts Indian as well as English, the income tax is in effect paid on behalf of the shareholder by the company. In both the Acts it is the company by

(3) The date on which interest is payable.

(4) Here enter the name of the local authority or the company.

its proper officer has to make a return of profits of the company. It is the company which is assessed on those profits and it is the company which is obliged to pay and thus pay the tax on those profits. The result is that the shareholder gets the balance of the profits after paying the tax. This is clear if Secs. 4, 11, 12 and Schedule 2 of the Income Tax Act of 1886 as amended up to 1916 could be compared with the English Act, Secs. 40, 54, and 100 of the English Income Tax Act of 1842 (*Martin J., in Parshottamdas Harkishandas* v. *The Central India Spinning and Weaving Co.,* (1918) 42 *Bom.* 579 *on pages* 585-586). In this case the Court further argued that though in a narrow technical sense it may be said that the company being a separate legal entity the net profits belong to the company and not to the shareholder, at any rate until a dividend has been actually declared. But in effect these net profits do belong to the shareholder. If therefore any sum has to be paid out of those net profits to the Crown for tax, in effect it is the shareholder who has to pay. The provisions of the Income Tax Act as to the assessment on and payment by the company are in effect mere machinery for the collection of the tax, and the matter is made much clearer if one sweeps away this machinery and regards the matter as between the Crown and the subject. In this case it was further laid down that as between fixed preference and ordinary shareholders in a joint stock company, the former are not entitled to have their preference dividends paid free of income-tax in a case where there are no express words to that effect in the contract regulating the rights of the parties.

In this connection the remarks of *Earl of Halsbury* in the case of *Ashton Gas Co.* v. *Attorney-General,* (1906) *A. C.* 10 are important. Here the question was whether the maximum rate of dividend which was fixed by articles to be given to shareholders in any year should include the tax or exclude same was the question at issue and the Court arrived at the decision that in arriving at the rate of dividend the profits ought to be calculated as

inclusive and not exclusive of the amount payable for the year in respect of income-tax. *Earl of Halsbury, L. C.*, in dealing with the question of the agency between the company and the shareholder expressed himself as follows :—

> "There is a somewhat difficult and complex machinery which makes the officers of the company, officers of the Finance Department of the Government for the purpose of collecting the tax."

Similarly *Rowlatt, J.*, in *Purdie* v. *The King,* (1914) 3 *K. B.* 112 on page 117 stated as follows :—

> "The company therefore is assessed and pays the tax. There is strictly speaking, no tax upon dividends at all; the company has to pay income-tax upon its profits as a company, and, having paid the income-tax, the effect is that there is less to divide among the shareholders. Sometimes the company declares what is called a dividend 'free of income-tax' which means that having paid income-tax, the dividend paid is less because there is less to divide. Sometimes it declares a dividend which it does not call free of income-tax and then it deducts a certain percentage from the dividend, stating that it is for income-tax. The real effect of the latter course is, not that the company has declared a dividend of the full amount and then deducted income-tax from it, but that it has declared a dividend of the net amount and told the shareholders that it would have been so much more but for the fact that the profits of the company were charged with income-tax before the dividend was made. Strictly speaking therefore, the suppliant has not been charged with income-tax at all in respect of interest and dividend. The charge is imposed upon the agents who pay the interest and upon the company which pays the dividends and the agents and the company have to pay the amount of the income-tax to the Crown in respect of that charge."

This reasoning of *Rowlatt, J.*, was doubted and declared inconsistent with the decision in *Ashton Gas Co.'s Case* cited above in *Brooke* v. *Commissioners of Inland Revenue,* 7 *T. C.* 261, but was followed in *Blott's Case,* 8 *T. C.* 101. (See also *Commissioners of Inland Revenue* v. *John Blott and I. Greenwood,* 8 *T. C.* 101; *Bradbury* v. *English Sewing Cotton Co.,* 8 *T. C.* 481; (1922) *K. B.* 569; *Sheldrick* v. *South African Breweries Ltd.,* (1923) 1 *K. B.* 173). For income-tax purposes the company and the share-

holder are separate entities, but the relations of the company and of shareholders to the revenue are separate and distinct (Per Master of Rolls in *Commissioners of Inland Revenue* v. *Lending Neumann and Co.*, 12 *A. T. C.* 84). According to the Calcutta High Court dividends in the hands of a shareholder are entirely exempt from the income-tax even in cases where a part of the dividend may have been paid from exempted profits in the hands of the company (*Re. Hungerford Investment Trust, Ltd.*, (1935) 1 *T. R.* 65).

INCOME TAX RETURN AND ADJUSTMENT OF ACCOUNTS

In case of Joint Stock Companies, it is required that the principal officer of every company must prepare, and on or before the 15th day of June in each year furnish, to the income-tax officer, a return (in the prescribed form and verified in the prescribed manner) of the total income of the company during the previous year [Sec. 22 (1)].

Provided that the income-tax officer may in his discretion extend the date for the delivery of the return in the case of any company or class of companies.

The return of total income of companies required by this section should be in the prescribed form.

The obligation to make this return is a statutory obligation upon the principal officer of the company and it is not necessary that the income-tax officer should send any preliminary notice or request to the company or to the principal officer concerned.

The tax payable by every company is at the maximum rate on its entire net assessable income of the previous year irrespective of what such income amounts to.

Assessable Income

For the purpose of arriving at the assessable income from business the usual profit and loss account prepared by the company showing the net profit of the business for the year may be taken as the basis but if in this

profit and loss account are charged any items of expenditure which are not allowed as deduction as detailed below such items, in order to arrive at the assessable profits of the business, have to be added back.

The following items of expenditure, if incurred in the usual course of business, are allowed to be charged in the profit and loss account prepared for income-tax purposes :—

(1) Any rent paid for the premises in which the business is carried on. Where the company occupies its own premises for business purposes no rent is allowed to be charged against business profits and the annual rental value of such property is not considered as income for the purposes of assessment under the head of "Income from Property."

(2) Cost of repairs where the company is the tenant only of the premises and has undertaken to bear the cost of such repairs.

(3) Interest on money borrowed for business purposes where the payment of interest is not in any way dependent on earning of profits.

(4) Insurance premium against risk of damage or destruction of buildings, machinery, plant, furniture, stocks or stores used for the purposes of business.

(5) Cost of current repairs to such buildings, machinery, plant or furniture.

(6) Depreciation on buildings, machinery, plant or furniture being the property of the assessee according to scheduled rates calculated on the original cost provided the prescribed particulars are furnished. If no depreciation or any part thereof could be claimed in any year on account of loss or insufficient profit, such unclaimed depreciation can be added to the

subsequent year's allowance for depreciation against such year's profits provided that in no case the total allowances for depreciation should exceed the original cost to the assessee in respect of such property.

(7) Obsolescence allowance in respect of any machinery or plant discarded, being the difference between the book value of the machinery or plant, (original cost less total allowances claimed), and the realised value of the machinery and plant when sold after being discarded or its scrap value.

(8) Loss by way of death of animals (or where they become permanently useless), in case they have been used for the purposes of business otherwise than as stock-in-trade. The basis of loss claimable as deduction is the difference between the original cost and the amount if any realised in respect of carcasses or animals.

(9) Any sum paid on account of land revenue, local rates or municipal taxes in respect of such part of the premises as is used for business purposes.

(10) Any sum paid to an employee as bonus or commission for services rendered where such sum would not have been payable to him as profits or dividends if it had not been paid as bonus or commission provided such bonus or commission is of a reasonable amount with reference to the pay of the employee, the conditions of his service, the annual profits of the business and the general practice in similar businesses.

(11) Any expenditure incurred solely for the purpose of earning such profits or gains, not being in the nature of a capital expenditure, such as salaries, wages, printing, stationery,

advertisements, discounts and all such general and trade expenses.

(12) Bad debts actually written off.

Deductions not Allowed

The following items are not allowed to be charged to the profit and loss account prepared for ascertaining the assessable income and if they are charged they are required to be added back :—

(1) Reserve for bad debts, or provision for any funds.

(2) Expenditure of the nature of charity or present.

(3) Capital expenditure.

(4) Cost of additions, alterations, extensions or improvements of any assets of the business.

(5) Sums paid for income-tax and super-tax, or any tax levied by any authority other than land revenue, local rates or municipal taxes in respect of business premises.

(6) Rental value of property owned and occupied by the owner of a business for the purpose of the business.

(7) Losses sustained in previous years.

(8) Any loss recoverable under an insurance or a contract of indemnity.

(9) Depreciation of any assets of the business other than the depreciation allowed as per scheduled assets under Section 10 (2) (vi).

(10) Any expense which is not incurred solely for the purpose of earning the profits.

(11) Sums paid for goodwill.

(12) Loss on speculation or gambling transactions.

(13) Any sum paid or set aside as appropriation of profits.

Bad Debts when allowed as a Deduction

A bad debt or irrecoverable loan cannot be allowed as a deduction unless

(a) the assessee has written it off his accounts,
(b) it has actually become bad or irrecoverable,
(c) it actually became so in the "previous year."

Loss by Embezzlement

Sums embezzled by an employee are allowed to be deducted against the business profits of the employer [Para 64 (v)].

A company's assessable income is ascertained in practically the same manner in which such income of any other business or trade is ascertained. If the usual profit and loss account is taken as the basis for filling in the return of income by the company, all expenses which are not allowed to be deducted should be added to the net profit as shown by such profit and loss account, and all incomes included in such accounts being in the nature of casual income or capital income or such as is not earned by the company in the ordinary course of its business are deducted from such profits in order to arrive at the figure of the total assessable income.

There are however a few items of a peculiar nature in connection with joint stock company organisation which require special mention here.

(1) Preliminary expenses incurred in connection with the registration and promotion of the company being in the nature of capital expenditure are not allowed as deductions from the revenue.

(2) Underwriting commissions, cost on issue of debentures, brokerage or law charges incurred in securing loans, are all treated as items of capital expenditure and not allowed to be charged to revenue.

(3) Premium on issue of shares or debentures as well as amounts received on forfeited shares being in the nature of capital income are not assessable.

(4) Interest on debentures. This is allowed to be charged against the profits of the company but

the company required to deduct in the first instance income-tax at the maximum rate before payment of interest to debenture-holders and account for the same to the Income Tax Authorities.

Obsolescence Allowance

The Obsolescence allowance is a deduction from business profits, and is made, in respect of the value of plant and machinery which has been sold or discarded on account of its being obsolete. This allowance is equal to the difference between the book value of such assets and the amount for which the same is actually sold.

In case of loss owing to obsolescence of Plant and Machinery the following example will illustrate the treatment in account.

Illustration

A factory machine is bought at Rs. 12,000. After its use for 5 years during which total depreciation was claimed to the extent of Rs. 2,000 the same being obsolete is sold for Rs. 5,000. Show the amount to be claimed against profits.

Machinery Account

	Rs.		Rs.
To Original Cost ..	12,000	By Depreciation A/c (claimed during 5 years)	2,000
		" Cash	5,000
		" P. & L. A/c being the loss claimable	5,000
Rs.	12,000	Rs.	12,000

Illustration

A bought a knitting machine for business use for Rs. 12,000 on 1st January, 1930 and was allowed a depreciation allowance of 5% per annum by the Income Tax Authorities upto 31st December, 1933, when having failed in business, he sold the machine to B for Rs. 6,000.

B used the machine in his business upto 31st December, 1936, during which period he was allowed the usual 5% depreciation allowance; on 31st December, 1936, he sold away the machine as having become obsolete, for Rs. 2,000.

What is the amount of obsolescence allowance (if any) that may be claimed by (1) A, (2) B?

A cannot claim any obsolescence allowance because he has not sold the machine owing to its becoming obsolete, but he has sold it on account of his business failure.

B is, however, entitled to an obsolescence allowance of Rs. 2,250 which is arrived at as under :—

	Rs.
Cost of the machine on 1st Jan. 1934	5,000
Less 3 years' depreciation @ 5%	750
Value of asset at the time of sale	4,250
Less Amount realised on sale	2,000
Loss on account of obsolescence .. Rs.	2,250

Illustration

Machinery was bought for Rs. 12,000 in 1934. Profits prior to charging depreciation at 5 per cent. thereon were in 1934 Rs. 800; 1935 Rs. 100; 1936 Rs. 400 and 1937 Rs. 1,900. What would be the amount of Depreciation to be charged against Profit of 1937?

Date.	Profits Rs.	Depreciation taken Advantage of Rs.	Amount Added to Subsequent Depreciation Rs.	Assessable Profit. Rs.
31—12—34	800	600	....	200
31—12—35	100	100	500	Nil
31—12—36	400	400	700	Nil
31—12—37	1,900	1,300	Nil	600

The amount of depreciation to be charged against profits of 1937 is Rs. 1,300. It may be added here that provision for Depreciation Fund is not allowed while computing assessable income.

Super-tax

A company is liable to pay super-tax in addition to income-tax in respect of its income in excess of Rs. 50,000 at the rate of one anna in the rupee, plus the surcharge of one pie in the rupee under the Finance Act of 1936.

Illustration

The Profit and Loss Account of A. B. & Co., Ltd., for the year ended 31st December 1935 showed as follows :—

	Rs.		Rs.
Rent	3,000	Gross Profit ..	85,000
Salaries	36,000	Sundry Receipts ..	4,750
Trade Expenses ..	13,000	Premium on Shares ..	30,000
Debenture Interest ..	7,000		
Income Tax ..	5,000		
Preliminary Expenses	5,000		
Loss on sale of Investments	3,000		
Depreciation :—			
Plant 10% ..	7,500		
Furniture 5% ..	250		
Net Profit ..	40,000		
Rs.	1,19,750	Rs.	1,19,750

You are required to adjust the above Profit and Loss Account for the purpose of ascertaining the net amount on which income-tax is payable for the official year 1936-37.

A. B. & CO., LTD., ASSESSMENT FOR 1936-37

	Rs.	Rs.
Net Profit as per Profit and Loss Account ..		40,000
Add Deductions not allowed for Income-tax purposes :—		
Income Tax	5,000	
Preliminary Expenses	5,000	
Loss on Sale of Investments	3,000	
Depreciation of plant (excess) ..	3,750	16,750
		56,750
Less Premium on Shares		30,000
Total Assessable Income	Rs.	26,750

Amount of tax is payable at the maximum flat rate.

NOTE :—The Debenture Interest is allowed as a business charge. The company will deduct income-tax at the maximum rate on this interest and pay the same to Government. Debenture holders will of course get a credit for the income-tax so deducted.

Illustration

You are asked to advise the directors of a Company what they will have to pay for Indian Income Tax and Super-tax for the official year to 31st March, 1938. The Company's accounts to 30th June 1937, show.—

	Rs.
Gross Profit	34,00,000
Salaries and General Charges	95,000
Rent, Rates, etc.	28,000
Income Tax	15,000
Managing Agents' Allowance	24,000
Managing Agents' Commission	51,000
Loss on Investments Sold	50,000
Reserve for Doubtful Debts	10,000
Bad Debts	15,000
Depreciation on Furniture at 10% per annum ..	2,000
Depreciation on Investments	30,000
Premium Received on Issue of shares	1,00,000

The Profits were appropriated as follows :—

Reserve Fund	5,00,000
Depreciation on Machinery at 7½% on cost ..	6,00,000
Dividend at 20%	8,00,000
Bonus at 5%	2,00,000
Staff Bonus	10,000
Balance Forward to next year	

Statement showing the Profit assessable for Income-tax and Super-tax for the year ended 30th June. 1937.

			Rs. a. p.	Rs. a. p.
Gross Profit				34,00,000 0 0
Less Expenditure :—				
Salaries and General Charges			95,000 0 0	
Rent, Rates, etc.			28,000 0 0	
Managing Agents' Allowance			24,000 0 0	
Managing Agents' Commission			51,000 0 0	
Bad Debts			15,000 0 0	
Staff Bonus			10,000 0 0	2,23,000 0 0
				Rs. 31,77,000 0 0
Subject to the charges being allowed.	*Less* Depreciation			
		On furniture	2,000 0 0	
		On machinery	6,00,000 0 0	6,02,000 0 0
				Rs. 25,75,000 0 0

Thus the total assessable income is Rs. 25,75,000 on which the company will have to pay income-tax.

ADJUSTMENT OF PROFIT FOR ASSESSMENT OF SUPER-TAX

	Rs. a. p.	Rs. a. p.
Profit assessable as above		25,75,000 0 0
Less Amount Exempted	50,000 0 0	
Dividend at 20 per cent.	8,00,000 0 0	
Bonus 5 per cent.	2,00,000 0 0	10,50,000 0 0
Income Assessable to Super-tax		Rs. 15,25,000 0 0

Illustration

The Soordas Cotton Mills Ltd., made a profit of Rs. 14,96,400 for the year ended 31st December, 1935. The Profit and Loss Account included a debit of Rs. 45,300 for Income-tax and Super-tax paid on the previous year's profits, and a credit of Rs. 1,50,000 for net interest received on Municipal Bonds. The profit was appropriated as under :—

	Rs.
To write off depreciation on Buildings at 5% ..	30,000
„ write off depreciation on Machinery at 7½% ..	1,80,000
„ write off the balance of preliminary expenses ..	20,000
„ write off the cost of debentures issued during the year	15,000
„ pay bonus to company's employees	25,000
„ transfer to the reserve fund	4,00,000
„ pay dividend	8,00,000
„ carry forward	26,400
Rs.	14,96,400

Find out the amounts of incomes assessable for Income-tax as well as for Super-tax for the year commencing 1st April, 1936.

SOORDAS COTTON MILLS LIMITED.

STATEMENT ADJUSTING THE PROFIT AND LOSS ACCOUNT FOR INCOME TAX PURPOSES

	Rs.	Rs.
Balance as per Profit and Loss Account ..		14,96,400
Add Income-tax and Super-tax paid ..		45,300
		15,41,700
Less Interest received on Municipal Bonds Income-tax on which has been deducted at source		1,50,000
		13,91,700
Deduct—The following items provided they are sanctioned and that the total depreciation written off does not exceed the original cost of the assets :—		
Depreciation on Building @ 5% ..	30,000	
Depreciation on Machinery @ 7½% ..	1,80,000	2,10,000
		11,81,700
Income assessable for Income-tax for year 1936-37		11,81,700
Income assessable for Super-tax		
Deduct Amount exempted	50,000	
Dividend Paid	8,00,000	8,50,000
Net Income assessable for Super-tax for the year 1936-37		3,31,700

INDEX

INDEX

A

C

G

H

I

J

M

O

P

S

U

V

W